

DEVELOPMENT BANKS IN ECONOMIC DEVELOPMENT:  
TWO LATIN AMERICAN EXPERIENCES: (NACIONAL  
FINANCIERA AND THE BANCO NACIONAL  
DE DESENVOLVIMENTO ECONÔMICO E  
SOCIAL)

by

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## ABSTRACT

This dissertation aims to investigate the role of development banks in financing economic growth in Latin America throughout the 20<sup>th</sup> century. Two study cases are examined: Nacional Financiera (NAFINSA) in Mexico and the Banco Nacional de Desenvolvimento Econômico e Social (BNDES) in Brazil. We use a comparative- historical approach to address similarities and differences between Brazil and Mexico in using financing to spur economic growth. In so doing, we expect to draw useful lessons for policy-makers. The dissertation consists of five sections. The introduction addresses the motive of this dissertation and outlines its approach and structure, and then closes with a necessary background discussion of what development banking is. Section 2 gives a brief historical review of the early progenitors of current development banks. Sections 3 and 4 constitute the bulk of the dissertation. They respectively investigate NAFINSA in Mexico and the BNDES in Brazil. The bulk of each section is a careful historical investigation of the structures and practices of each bank, including in particular how they changed over time. Each of the two sections concludes with a short discussion of implications suggested by that case study. The final brief section 5 of the thesis is a combination of the suggested implications for development banking in Latin America from the two case studies.

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## CHAPTER 1

### INTRODUCTION: MOTIVATION AND DEVELOPMENT BANKS

#### 1.1 Motivation

The explosion in the number of development banks is a post-WWII phenomenon. It is a result of the acceptance after the war of the belief in the need for national policies to foster industrialization to promote development. A 1967 OECD study listed 334 institutions that were considered to be, or by their functions could be considered to be, development banks (Nyhart and Jannsens 1967). Half of those had been in existence less than 10 years, and many of the others were earlier post-WWII creations (see Kane 1975, 3). The Japan Development Bank (JDB), the Kreditanstalt für Wiederaufbau (KfW) in Germany, the Industrial Development of Canada, and the Korean Development Bank (KDB) were some of the banks that were established after the WWII. The United Nations reported in 2005 about 520<sup>1</sup> national development banks for a total of 185 countries, for an average for these countries of 2.8 development banks. Underdeveloped countries have on average three or more development banks, while developed countries tend to have fewer institutions. According to the report, the region with the largest number of development banks with 152 is Latin America and the Caribbean. Of course, the number of banks does not directly determine the amount of resources, since in some

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<sup>1</sup> Felipe Guth (2006, 47) points out a possible source for an overestimation of the number of development banks. Some Islamic countries have laws against usury by commercial banks, defined as making money by lending money. Then some banks in those countries that carry out the activities of commercial banks classify themselves as development banks. Since this is not generalized even throughout the Islamic world it is not a major distortion, but it does occur in some countries such as Saudi Arabia, Iran, and Afghanistan.



cases, developed countries can mobilize a greater quantity of resources and thereby have a large impact on their economies with their smaller number of development banks (United Nations 2005a, 5).

After WWII, some development banks were successful and others did not prosper. Reasons for failure or success could have been the internal social, economic, and political characteristics of each country and the international context where these banks operated. The neoliberal period undoubtedly weakened the idea of strong states fostering industrialization. However, important to this dissertation is that currently development banks are still considered important to spur economic and social development.

Following a meeting in Quito (Ecuador) in May 2007 at which it was announced that the Banco del Sur would be created, on September 26, 2009, the presidents of Brazil, Argentina, Venezuela, Ecuador, Bolivia, Uruguay and Paraguay signed an agreement establishing the bank with an initial capital of \$20 billion. The bank was intended to replace the International Monetary Fund (IMF) and World Bank as a source of borrowed capital for countries in Latin America, in particular for infrastructure and social projects. This immediately suggests a historically important question for Latin America and the motivation for this dissertation: what is necessary for this bank to succeed in its mission? What sort of structure and what sort of policies would be best suited for such a development bank, in the given context of Latin America?

Brazil and Mexico are the two largest economies in Latin America. Both of them have had a development bank that was extremely successful at particular periods in their country's history, and not so successful in other periods. This then provides us with two natural experiments, two case studies, of development banks in Latin America.

The economic question that will be addressed by this dissertation is: what conclusions can be supported<sup>2</sup> by a detailed study of these two development banks? The studies will cover their entire histories, which means that the studies will include major

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<sup>2</sup> Case studies can never "prove" the superiority of particular structures or procedures.

changes in the banks' structures and procedures, and major differences in different time periods in their success in their central goal of contributing to their country's development. Hence, these studies will involve a collection of different natural experiments which will generate the rich variety that is necessary for comparing different possible approaches by a development bank to the desired promotion of development.

The dissertation will consist of five sections. The introduction will briefly motivate the dissertation, outline its approach and structure, and then close with a necessary background discussion of what development banking is followed by a short and broad comment concerning the states that are behind state development banks. Section 2 will give a brief history of the progenitors of development banking. Sections 3 and 4 will constitute the core of the dissertation. They will respectively investigate Nacional Financiera (NAFINSA) in Mexico and the Banco Nacional do Desenvolvimento Econômico e Social (almost always shortened to BNDES) in Brazil. The bulk of each section is a careful historical investigation of the structures and practices of each bank, including in particular how they changed over time. Each of the two sections will conclude with a short discussion of implications suggested by that case study. The final brief section 5 of the dissertation will be a combination of the suggested implications for development banking in Latin America from the two case studies.

As suggested by the opening comments on motivation, these conclusions will hopefully be of value for the ongoing consideration of the structure and procedures of the Banco del Sur. A note of caution, however, is that the intent is to learn from the past without being enslaved by it. A popular "definition" of insanity is to do once again what has repeatedly failed and expect success. It is important to know the past to avoid its errors. But the past can also give suggestions on what might work for the present, if one makes the necessary modifications to adapt successful past procedures to a present that is always different from the past. All of this, however, is only a presentation of mo-

tivation: this dissertation will not directly further discuss the project of the Banco del Sur.

The rest of this introduction will discuss the necessary background issue of what a development bank is, followed by a short and broad comment concerning the states that are behind state development banks.

## 1.2 Development Banks

This section discusses four issues concerning development banks: firstly, what a development bank is; secondly, what sectors development banks can foster; thirdly, what type of ownership can be possible; and finally what kind of enterprises, public or private, can receive resources.

A sensible first step for developing some aspects of a definition of a development bank would be to look for commonalities in the structures of institutions which are called development banks. Unfortunately, as many authors point out:

There is no universal model to which development banks conform. Each bank is structured with the political, social and economic fabric of the country in mind. And each in its own way is a unique institution. (Kane 1975, 13)

The fact is that development banks come in forms so diverse, with functions so diverse, that, despite similarities in name, they have little in common; and institutions with quite different names often have attributes generally associated with development banks. The Development Industrial Bank of Egypt, the State Investment Bank of Turkey, the Korean Long-Term Credit Bank, the Industrial Credit and Investment Corporation of India, the Bank of North-East Brazil, the Finance and Guarantee Fund for Small-Industry in El Salvador, the Finnish Industrialization Fund, the Columbian Finance Corporation – all these differ widely in ownership, scope of activities, policies and operations; yet they perform the functions of a development bank. (Diamond 1957, 3-4)

Hence, structural commonalities cannot serve as a basis for a definition of development banks. Notwithstanding the repeated assertions in the second quote that their functions also differ markedly, both these authors and most others turn to the functions of the institutions as the basis for defining development banks. In fact, it is in the broad nature of the functioning of the institutions that one finds the commonality for a

definition, despite the great variety of specific functions that Diamond, a leading mainstream authority on development banks, correctly notes. “I started by saying I would define a development bank, but one can do so only in terms of functions” (Ibid., 5).

Once it is established that the definition of a development bank should come from its functions, the name “development bank” immediately suggests the two functions that an institution must fulfill to carry this label (both functions equally important): 1) it is a financial intermediary, and 2) it must have the goal of promoting development (Maug 1973, 6-7; Ramírez 1987, 22; Diamond 1981, 4; Guth 2006, 49). Both functions must correspond to the overall national economic policies carried out by the respective country, for the way in which the development banks carry out these two activities can vary enormously between countries. The economic, political, and social conditions of a country and the concept of development of its government interact to give very different structures and practices.

Additional consideration of the two aspects just mentioned will help to further clarify what a development bank is. First of all, while it is a financial intermediary, it is not what is usually simply called a bank, meaning a commercial bank, because the main activity of commercial banks is short-time lending. Due to the nature of the process of development, development banks to the contrary have to provide medium- and long-term finance. Further, they often carry out other roles in addition to lending not engaged in by commercial banks. Development banks carry out some mixture of three activities: 1) long-term loans (similar to an investment bank, to be discussed below), 2) holding equities and “. . . managing specific companies as well as . . . providing financial support” (Diamond 1957, 2), and 3) providing technical assistance.

Second, in relation to its objective of development, many development banks focus on a limited specific number of sectors of the economy according to the needs of the country, such as agriculture, industry, or building infrastructure such as railroads,

subways, universities, hospitals, etc. Often a development bank will be entirely dedicated to development in one sector. Or in some cases and according to the circumstances, a development bank would promote import substitution or encourage exports.

There is disagreement in the literature about what sorts of sectors development banks should promote. We will see below that development banks came out of industrial banks, and some authors such as Bosky (1959, 3) still argue that industrial activities should be the priority for a development bank. As opposed to a particular sector, recently some advocates have argued that given the skills of both workers and managers in many less developed countries, development banks should focus their efforts on Small and Medium Enterprises (SMEs). Contrary to these or other restricted views, however, most authors have come to see development banks as appropriate for any sector of the economy that the government wants to promote the development of. While no one argues development banks should only be for agriculture, the importance of this sector to one of the most basic priorities of development, adequately feeding the population, has meant under the approach of developing whatever sector is needed, agricultural development banks flourished in the half century after WWII, until the neoliberal paradigm put a damper on all development banks.

Third, there is also disagreement in the literature about the issue of public versus private ownership of a development bank. No one argues that all development banks should be private, for to do so would be entirely at odds with the actual history of development banks since WWII. One group including Diamond (1957) and Ramírez (1986) argue, in line with neoliberalism's overall advocacy of privatization, that a development bank can be public, private, or a combination of both. A much smaller group rejects this approach and continues to promote the position that was dominant after WWII before neoliberalism, that development banks should be “. . . government-sponsored financial institutions . . .” (Armendáriz 1998, 1).

Finally, there is also disagreement in the literature about the issue of the public versus private nature of the enterprises that should be promoted. Diamond (1957, 4) argues that a development bank should promote only the private sector of an economy.<sup>3</sup> The opposite view is argued in a United Nation's document (2005b, 10), “. . . Development banks are a financial instrument of national development policy whose performance is measured more in terms of social benefits generated. . .” and by Felipe Guth (2006, 51) who says that a development bank has to contribute to increase employment and to improve distribution of income. The common “middle ground” between these two views can be found in Kane (1974,14):

Development banking, it is suggested, is neither so narrow in scope as to be limited to institutions financing profit-oriented private-sector investment projects only, nor so broad as to be a general channel through which funds are directed to any development-oriented project or program.

The following by Diamond<sup>4</sup> can serve as a terse definition of a development bank that includes brief references to some of the various considerations just discussed:

The principal function of a development bank is the provision of medium- and long-term finance for fixed assets. It also helps to provide, in addition to finance, such other essentials of productive investment as entrepreneurship, technical skills and managerial experience. It relies on the success of the enterprises it finances for recovery of the investment rather than on the security of collateral, and it does so in a manner that balances commercial standards of operation with economic benefit.<sup>5</sup> (Diamond 1957, 4)

### 1.3 States Behind State Development Banks

It was established above that although this dissertation will not directly discuss hypotheticals concerning the Banco del Sur, it is motivated in part by the desire to draw

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<sup>3</sup> For Diamond, financing the public sector is more related with planning.

<sup>4</sup> The definition that will follow is consistent with Kane's middle-of-the-road definition just given, and not with the just-previously cited position of Diamond that they should only fund the private sector. This definition allows public enterprises, and specifically argues that commercial considerations, be balanced with social welfare confederations, but does require that and such public enterprises generate enough income to pay back their financing. This would then argue that development projects that are not designed to generate such revenue, such as for example, a toll-free national road system, are not appropriate for development banks and should be funded through other channels.

<sup>5</sup> Joseph Kane (1974) makes a similar but much more extended argument concerning definition by function in Chapter 2. Along the same lines of a functional definition, see Mya Maung (1973, 6).

positive and negative lessons concerning possibilities for promoting development in the Latin American context that conceivably could be used by such an institution. But a note of caution concerning the use of lessons from the case studies of NAFINSA and BNDES is necessary as part of the background material for the dissertation in this introductory section.

Like the majority of the post-WWII development banks which were created by the state and operated under its the supervision, from the perspective of the state, the purpose of the two banks that will be studied, even when building or directing state projects or enterprises, was to facilitate and promote the accumulation of private capital, in the short-, medium- and long-run (like all development banks throughout history, private or public, that existed in capitalist societies). However, as scholars such as Ares (2007) have stressed, the state is not simply an instrument at the service of the bourgeoisie. They maintain that the state does have some degree of autonomy, its decisions are based in part on the discretion of the policy makers. Ares goes on, however, to recognize at the same time the important limitations to its autonomy that come from the state being embedded in a society dominated by the logic of markets focused on the maximization of profits.

Following Hamilton (1983), this dissertation takes as part of its background assumptions that the state backs and supports the bourgeoisie in its pursuit of the accumulation of capital. In underdeveloped countries, this intervention by the state is particularly important because of the weakness of the bourgeoisie. More specifically, among other functions, the state in underdeveloped countries typically intervenes strongly in support of private capital accumulation in the following five ways: i) creating infrastructure; ii) more broadly along the same line, carrying out any nonprofitable activities that are necessary or even useful for the accumulation of capital; iii) developing and codifying private property laws and institutions to regulate the relation between labor

and capital; iv) regulating in the general interests of the nation's capital conflicts that arise between specific capitals pursuing their partial interests; and v) once a country's capital has reached a certain level of development (Brazil being a clear example today), the expansion of national capital in the global sphere.<sup>6</sup>

As this dissertation is being written, there is a battle going on over what the nature will be of the Banco de Sur. One side would like to see the bank be a development bank of a type that has never previously existed, one that genuinely focuses directly on promoting human well-being as opposed to promoting private capital accumulation with the background argument that this will necessarily promote human well-being. The other side is fighting to make it a traditional development bank that serves private capital accumulation. A particularly important aspect of this fight is that the Banco del Sur will not be subservient to any single state, and cannot therefore be directed by a single state to carry out the sorts of support for private capital accumulation just listed that development banks are typically used for by capitalist states. Whether the one side will succeed in making it like the World Bank or the existing regional development banks (an extension to a supranational level of the role of promoting private capital accumulation) or the other side will create a new type of development bank remains to be determined by history. The research for this dissertation is being conducted with the perspective that even if it becomes a new type of development bank that directly promotes development for human well-being, there are many lessons from the experiences of the capitalist-state backed NAFINSA and BNDES that, notwithstanding their different goal of supporting private capital accumulation, could be usefully translated into the frame and goal of the new development bank and contribute to making it successful.

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<sup>6</sup> Alvater (1973) discusses the latter two more.



## CHAPTER 2

### HISTORICAL REVIEW OF THE EARLY PROGENITORS OF DEVELOPMENT BANKS

#### 2.1 Introduction

Banks in some form have existed for several thousands of years, and for several hundreds of years in forms more similar to current banks. However, despite this long history of banking, it was only very recently, in the 1800s, that some banks began to focus on what is the concern of this dissertation, financing the development of production, beginning with industrial production. This was a result of the exponential growth of industrial production at that time. These banks, located in what today is referred to as the First World or developed countries, were then referred to as “investment banks.” These were profit-oriented banks and they were owned by private capital. As opposed to this, today, particularly in underdeveloped countries, the biggest banks whose purpose is to provide “medium- and long-term finance” for industry, agriculture, and other basic parts of the economy necessary for development, are generally government-sponsored institutions known as development banks.<sup>7</sup> Their main goal is not profit, but rather promoting, fostering, and financing the development of some particular economic activity, or a variety of economic activities.

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<sup>7</sup> As indicated in the opening section of this dissertation, today the terms “industrial bank,” “development bank”, and many other similar terms are used very inconsistently in the actual names of these banks in both the First and Third Worlds, but the distinction between (and arguments concerning) government sponsored banks versus private banks continues to be an important issue.

This section will briefly review the birth of development banking; its concern is the growth of this type of banking prior to the particular two case studies of development banking that are the focus of this dissertation, Mexico and Brazil. The important subject here with this history is not as part of a study of development banking in itself. This brief consideration of the history of development banking is necessary rather for an understanding of the environment in which these two banks emerged. After this introduction, this chapter will first consider the first industrial banks. It will then consider specifically the cases of Germany and Japan where banks in general, and investment banks in particular, came to play such an important role in the process of investment in the economy. The final section in the chapter will look at the history of development banks in the 19<sup>th</sup> century in underdeveloped countries.

## 2.2 Development Banks as Investment Banks

During the incipient industrialization of England in 18<sup>th</sup> century, the mercantile British state played a role: 1) protecting domestic markets in order to obtain a favorable trade balance, and 2) opening foreign markets through military power. However, neither the British state nor the private sector had an important participation in the industrialization of England during the 18<sup>th</sup> century through banks whose overall business was focused on loans for industrial development. This was not necessary, because the early stages of industrialization required relatively small amounts of capital. These were originally provided almost entirely by merchants, and later by reinvesting the capitalists' profits. When additional capital was needed beyond what could be provided by autofinancing, it came from either the existing commercial banks (Diamond 1957, 17; Itoh and Lapavistas 1999, 84) or capital markets (Hermann 2002, 71). Commercial banks granted capital in two ways (Cameron 1961, 12): 1) local banks granted working capital, 2) some banks were created by a capitalist or a group of capitalists to finance

their own activities, but these were relatively small because 1) there was no possibility of limited liability, and 2) because bank partnerships were not allowed to consist of more than six people.

By the 19<sup>th</sup> century, continental Europe faced a different situation. To begin with, the amount of capital needed for modern investment projects was continually growing. Second, there was a shortage of capital in comparison to the needs, since long-term investment in heavy industries such as railroads were beyond the possibilities of one person, family, or group. Ongoing changes in capitalism involving more complex forms of property and necessitating more complex forms of credit reinforced this shortage of capital in comparison with needs. Third, even though some countries such as France had significant initial industrialization and progress in science and technology (see Hobsbawm 1997, 37 and Cameron 1958, 2), all the continental countries felt they were behind Great Britain and had to “catch up.” They felt the need to both launch large long-term projects in infrastructure such as railroads and canals, and to develop heavy industry like electricity and chemistry. And even though being a “late developer” can potentially generate the well-known technological advantages of transfers, imitation, and copying, it can also pose less discussed problems concerning available capital. As Diamond points out:

The mere fact of following, while providing the opportunity for imitation, also created difficulties. For once the urge to develop emerged, there was a keen desire to do so quickly, to “catch up” with the leader. This was an expensive task, partly because of the high capital outlay required to take over the latest techniques of production and implant them in an economy relatively primitive, partly because of the need to lay down quickly the costly base of overhead facilities (especially transport) essential to rapid growth, and partly because of the conviction that investment in many fields simultaneously was essential to quick development. Sudden increases in the scale of production and investment were necessary in countries seeking to transform their economies rapidly, which had not been necessary in Britain earlier. (Diamond 1957, 21)

It was in this context that development banks as private industrial banks arose in continental Europe (see Diamond 1981; Kane, 1975). The first investment bank

for industrialization in continental Europe was the Société Général pour Favoriser L 'Industrie National in the United Kingdom of the Netherlands in 1822<sup>8</sup> (Diamond 1957; Arméndariz 1998; Da Rin and Hellman 2001). This was a joint-stock investment bank founded by King William I. In its first years of existence, it carried out the functions of issuing bank notes, discounting bills of exchange and securities, cashiering for the Kingdom, accepting deposits, and providing short-term credit (Cameron 1972b, 132). In fact, during its initial years, this bank did not contribute significantly to promoting industrialization. Only after the independence of Belgium in 1830 did it become more active as an industrial promoter. According to Da Rin and Hellman (2001, 8), "Belgium . . . achieved its industrialization roughly between 1830 and 1850. Over this period, its GNP grew yearly at 2.5 %, well above the 1.4 % European average," and in this Belgian growth, the Société had a very important role.

The Société Général implemented projects mostly with its own private capital, since only a small amount of resources were available from deposits. Three particularly important investment-related actions carried out by the Société were the following: 1) during the economic crisis at the end of the 1820s, the Société took companies with debt problems and converted their short-term credit to long-term credit and subsequently sold shares of these companies, thereby fostering a stock market; 2) from 1830 onward, it continually expanded its encouragement of financial, commercial, and industrial ventures; and 3) the Société provided technical assistance to advise especially mining companies (Deloof et al. 2007, 7). Hence, the Société carried out all the functions that were discussed in Chapter 1 as defining a development bank; granting long-term credit, promoting stock, and providing technical assistance.

By 1870, the activities of the Société Général along with the rest of the Belgian financial system had contributed to making Belgium the most industrialized country

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<sup>8</sup> The Société Général pour Favoriser L 'Industrie National was established in Belgium, but until 1830, Belgium was part of Netherlands.

of Europe (Cameron 1972b, 129). Two points concerning this development should be appreciated: that in a time of political crisis and economic need a new type of institution developed, and that this institution served the independent development of Belgium very well.

The next milestone in the development of investment banking was the Société Générale du Crédit Mobilier. This was founded by the Brothers Pereire<sup>9</sup> as a Joint Stock Company in November, 1852. Both brothers belonged to the Saint-Simon brotherhood and were experts in economic issues. Eckalbar (1979, 84) stresses the importance of their membership in the brotherhood, from which they took both the general idea of the importance of banking, and the specific idea that bankers must direct production to the benefit of the workers. Compared to the earlier Belgian Société (which was still very active at this time), an important new aspect of the Crédit Mobilier, as suggested by its name, was its much broader channels for mobilizing credit. This enabled it to provide a much greater volume of capital, which was increasingly necessary as industrialization continued. In addition and equally directly important to the topic of this dissertation, it deepened the integration of banking into production, financing, mining, and manufacturing. Finally, as opposed to just seeing itself as involved in profitable opportunities, it was explicitly conscious that “the mobilization of credit and the marriage of banking and industry” (Cameron 1953, 463) which it carried out was essential in the process of creating modern infrastructure and enterprises, and from that the development of a country.

The Crédit Mobilier was a stock company with three basic functions (Newmarch 1858, 444 - 445): 1) it was a Trading Association which could contract loans, build for example railways, and manage for example coal and gas and omnibus companies, 2) it could buy other trading companies, and 3) it was a universal bank. The funds of the

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<sup>9</sup> Émile and Isaac Pereire were financial advisers for James Rothchild until they had enough money to be the main stockholders of the Crédit Mobilier. The Rothshilds, one of the most important families in France, dominated European finance throughout the 19<sup>th</sup> century.

Société came from both from its members and from deposits by the public (Ibid., 445). During its lifetime, the Crédit Mobilier financed a relatively narrow set of infrastructure projects like railroads and steamboats, and a relatively narrow set of productive enterprises such as ones in the coal and gas industries. Geographically, however, it was very new in that it operated not only in France but also in Germany, Austria, Switzerland, Spain, Italy, Russia, Turkey, and Holland.

Gerscheskron argues that the brothers Pereire were central to the rise of industrial banking which was so important to modern development. Specifically, they made an extremely important innovation in expanding the credit in France and Europe at a low rate of interest. This started a spiral of increasing financing that led to the emergence of other banks that focused on investment in industry and to the increase of long-term credit by haute finance,<sup>10</sup> when neither the Bank of France nor haute finance had earlier been disposed to grant long-term credit. Gerchenskron (1965, 13) points out:

When the Rothschilds prevented the Pereires from establishing the Austrian Credit – Anstalt, they succeeded only because they became willing to establish the bank themselves and to conduct it not as an old fashioned banking enterprise but as a *crédit mobilier*, that is, as a bank devoted to railroadization and industrialization of the country.

It is important to note that leaving aside its other major banking activities mentioned above of buying commercial companies and universal banking, the Crédit Mobilier's development financing was quite narrow. It financed mostly railroads, although its influence in that area was impressive: "Due in large measure to its aid, the French rail network expanded from 3,600 kilometers in 1852 to 18,000 kilometers in 1870" (Came-

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<sup>10</sup> Haute Finance were the most powerful international banks in Europe in the 19<sup>th</sup> century and at the beginning of the 20<sup>th</sup> century. These banks not only carried out activities such as local and international lending, but also they were involved in geopolitics around the world in order to secure easy profits. Although it was independent of any European government, Haute Finance had close relations with governments in regard to geopolitical issues that were important to their profits, such as wars. In regard to the relation of Haute Finance to this financially important issue of wars in the 19<sup>th</sup> century, Polanyi points out: "The Rothshilds were subject to no one government; as a family they embodied the abstract principle of internationalism; their loyalty was to a firm . . . They were anything but pacifists; they had made their fortune in the financing of wars, they were impervious to moral consideration; they had no objection to any number of minor, short, or localized wars. But their business would be impaired if a general war between the Great Powers should interfere with the monetary foundations of the system." (Polanyi 2001, 11).

ron 1961, 147). However, it had little involvement in promoting anything approaching a broad industrial agenda. Because of this, France's rate of capital formation to foster economic activities was low, and hence, its rate of growth of total industrial production and the economy was slower in the second half of the 19<sup>th</sup> century than the other European countries such as Germany (Cameron 1958, 2). While the activities of the *Crédit Mobilier* were to continue until 1867, more important was that a number of other banks were founded in Europe starting in the 19<sup>th</sup> century following its model. However, the further development of the essential aspect of development banking, the close connection between banks and productive activities and enterprises, was to come out of Germany.

### 2.3 Germany

In the second half of the 19<sup>th</sup> century, the German states (27 territories) took the development of industrial banking a step further. According to Tilly (1972, 151), in the first half of the 19<sup>th</sup> century, these states were well behind other countries like Britain, France, and Belgium in economic growth and development. Universal banks did exist in Germany since the 1830s, mainly involved with the construction of railroads, but economic growth could not be unleashed because of restrictions by the government (for example in the formation of joint-stock companies), the church, and the aristocracy. Haute Finance at that time lent to the governments rather than to capitalists and therefore “. . . whatever private bank lending for industrial purposes that was done before the 1840s, was a relatively local phenomenon, confined to the nascent industrializing areas themselves . . .” (Tilly 1972, 160).

During the 1830s and the 1840s, the important textiles, iron, and coal industries were supported largely by retained profits or by merchantil capital. As stated by Cameron (1953, 465) and Diamond (1957, 26), it was then that interest in the idea of (broad, beyond railroads) industrial banking began to develop in Germany with the help

of the French *Crédit Mobilier*. The *Crédit Mobilier* participated in the foundation of the bank of Darmstadt in 1853, which was to serve as a model to the German big banks that emerged in 1870s. Tilly (1972, 176) points out that the relationship between banks and joint-stock companies grew after 1840s. Banks then contributed to the industrialization of Germany and to the high rates of economic growth from the 1850s to the 1870s. Table 2.1 shows the impressive rate of growth of the production of coal and iron in this period.

The important issue for the history of the development of investment banks from the German development is that in the second half of the 19<sup>th</sup> century, the relation between the industries being promoted and the banks promoting them developed to a much greater degree than had occurred with any previous industrial banks. The relation was not only through mobilizing long-term credit, but it also involved the following five additional aspects: 1) because Germans banks were universal banks, they provided, in addition to the long-term credit necessary for creating the industry, the short-term credit necessary for its daily operations; 2) German private banks provided credit through a current account,<sup>11</sup> which allowed for the relation between banks and industrial companies to be reciprocal: both banks and companies could be either debtors or creditors to the other, and this could be in the short or long term; 3) banks helped enterprises to raise capital even when it was direct and not through banks (for example, through

Table 2.1 Indicators of German Industrial Growth, 1840 – 1870.

Year	Pig Iron Output (tons)	Hard Coal Output (mill. Tons)
1840	173982	3.2
1850	211639	5.2
1860	545299	12.3
1870	1391124	26.4

Adapted from Source: Tilly 1972

<sup>11</sup> Neuberger and Houston define the current account as “. . . a combined demand-deposit account and line of credit. Interest was paid on credit balances at a rate of one percent under the Reichsbank discount rate and charged on debit balances at one percent over that rate plus minor fees” (1974, 713).



a stock market), through the creation of a good reputation for companies they worked with, and then they connected further to the companies by floating securities, underwriting them, and even holding some of the equities themselves; 4) industrial companies received “technical advice and managerial talent” from the banks (Diamond 1957, 25); and finally, 5) as opposed to Belgian and French universal banks, German universal banks were represented “...on the supervisory boards of joint – stock companies...” (Edwards and Ogilve 1996, 428).

One example of this is in railroads, as Tilly comments (Tilly 1972, 179; see also Edwards and Ogilve 1996, 434):

From the beginning Rhenish bankers were engaged in the organization and financing of the Rhenish Railway Company. . . Their current account advances and brokerage services kept the company afloat throughout the difficult early years of the 1930s and 1840s. They rewarded themselves with promotional and stockjobbing profits while maintaining their positions of influence within the company by holding or obtaining voting rights over significant blocs of its shares, and by occupying strategic positions upon its boards of directors. This pattern was repeated in the development of other railroads

The conventional view, and the one adopted in this dissertation, is that in Germany, the banks played an extremely important role in the industrialization and development<sup>12</sup> of the country. Gerschenkron argues there is a relation between banks and companies “...from the cradle to the grave, from establishment to liquidation throughout all the vicissitudes of its existence...” (Gershenkron 1992, 94). Tilly (1992, 94,) argues that German banks had a positive influence above all in heavy industry and new companies such as metals, engineering, utilities, and transportation:

Despite some dissent, the historical literature generally attributes to the banks a positive and significant contribution to Germany’s economic development in the 19<sup>th</sup> century. This contribution consisted in the financing of risky investments, particularly heavy industry, and included entrepreneurial feats such as the formation of new enterprises.

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<sup>12</sup> Especially later, the banks are considered to have been central to large parts of all economic activity and growth in Germany, but the concern of this thesis is only their role in industrialization and development.

Finally, Goldschmidt (quoted in Diamond 1956, 26) argues the banks actually really direct many of the big companies of Germany all the time:

Scarcely a single important company in Germany had been founded without the collaboration of a bank. Whether it is a case of converting a private firm into a limited company, or of exploiting a new invention by establishing a new enterprise, the assistance of a bank is always involved. The Bank examines the situation and, when necessary, obtains reports from experts in the particular line...If the bank, after examination, decides to found the company, it draws up the scheme of financing, determines the amount and types of capital to be issued and then, in some cases itself takes a part of the shares into its security portfolio with the idea of issuing.

## 2.4 Japan

The intent of this section is not to review the development of industrial banks in Japan even as briefly as I reviewed the prior development in Europe and in particular Germany, but only to highlight two important differences in the development in Japan, in regard to my further considerations of development banking in this dissertation. The first was the much stronger participation of the state in the process of mobilizing savings for industrial development. The second was the formation of competing industrial groups with their own particular bank and financial system.

The marriage between banking and industry in Japan involved a very strong participation by the state. This state's leadership played an essential role in the transformation of Japan from an agricultural country to an industrial one during the Meiji era, roughly from 1868 to 1912. The result was that Japan's economy grew at almost 4 percent per year during this whole period (Patrick 1967, 242). Specifically in regards to the overall process of providing industry with the finance for investment, as opposed to the European system, the state mobilized the population's potential savings and then lent these to private banks which in turn lent them to industry. Lazonick and O' Sullivan (1995, 36) point out that:

After the Meiji Restoration of 1868, Japan did not possess institutions that could provide the financial commitment required for sustained industrial development. Yet the restoration had put in power a political elite who were determined to industrialize the economy. In the early 1870s, as an alternative to borrowing on foreign capital markets, the Japanese instituted the postal saving system to mobilize household saving in the hands of the government. The Japanese state then made this money available to private banks engaged in the financing of industry

The private industrial banks had a different relation to industrial enterprises than in Europe. In Europe, we saw above that industrial banks were open to consider any enterprise's industrial project that seemed to be potentially profitable. In Japan powerful competing industrial groups, conglomerates of industrial enterprises, formed with their own particular bank and financial system. These groups were called *Zaibatsu*, and four of the largest ones were Mitsui, Sumitomo, Yasuda, and Mitsubishi. They emerged in the second half of 19<sup>th</sup> century and expanded during the 20<sup>th</sup>. This structure gave the industrial enterprises very favorable access to finance.

Hence, the specific form for financing the development of industry in Japan was 1) the State accumulates savings from the public, 2) the central bank channeled these deposits to private banks, and 3) private banks granted long-term credit to companies that belonged to their corresponding *Zaibatsu*.<sup>13</sup>

Notwithstanding the specific differences from Europe and the cautions expressed in the last footnote, it thus seems safe to conclude in regard to the central concern of this dissertation that like Europe, industrial banks were important to Japan's indus-

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<sup>13</sup> There are two minority challenges to this common view of industrialization in Japan. One is that the Japanese industrialization was actually carried out through stock markets. Miya and Ramseyer (2002) demonstrate this was the case for textiles, railroads, and electrical utilities. Lazonick and O'Sullivan (1995), however, argue that while stock markets were indeed important for these three industries, that was not the case for any others. A more serious challenge to the standard picture comes from scholars who do not question the participation of the *Zaibatsu* in the industrialization of Japan, but rather their extent. Patrick (1967, 286), for example, argues that as late as 1912, the five most important banks did not dominate the Japanese banking system, since at that time, these banks only concentrated 20.6 percent of the total security holdings in Japan, 17.7 percent of the total loans, and 20.5 percent of the public deposits. Similarly, for Yamamura (Cameron 1972a, 21) the *Zaibatsu* only became relevant after the 1920s, after the period of basic industrialization.

The common view remains dominant, and is accepted as roughly what happened in Japan in this dissertation as it considers development banking alternatives.

trialization. As Cameron (1972a, 22) stated: “In spite of these problems it is possible to draw two firm conclusions about the role of banking in Japanese economic development: the role was an important one, and much research needs to be done to determine its modalities and mechanisms.”

## 2.5 Early Industrial Banks in Underdeveloped

### Countries – The Case of Mexico

Much less known than the development of industrial banking in Europe and Japan are some early scattered experiments in America. Interestingly, and connected to the much smaller private capital that was available and interested in developing industrial banking, two such early experiments in Mexico involved totally government-sponsored industrial banks; Banco del Avío Minero and Banco del Avío.

For almost three centuries, Mexico was a Spanish colony called New Spain. The conquest by Spain of the area that was to become Mexico ended in 1521, and Mexico achieved its independence in 1821. During this period of time, the most profitable economic activity was mining, especially silver. Spain needed silver to pay its soldiers for its many wars,<sup>14</sup> and to buy manufactured goods from other Western European countries, particularly Holland, Germany, and England. According to Sólis (1965, 65), the majority of the silver extracted from the Spanish possessions came from Mexico.

The exploitation of the mines was a difficult activity that required a significant amount of finance, but in almost three centuries, the Spanish authorities did not find any important financial institution for Mexican economic development. The only two financial institutions were the mint (casa de moneda) and national pawn shop (Nacional Monte de Piedad) (Brothers and Sólis 1996, 5).

The wealth in New Spain was controlled by two powerful groups, the Catholic

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<sup>14</sup> Mostly in the 18<sup>th</sup> century.

Church and the merchants. For various reasons, the Catholic Church was never involved except peripherally in mining.<sup>15</sup> Given that the state barely participated at all in the economy for the first 200 years, it then was the merchants who came to head up the entire Mexican system of production (except that run by the Church), and in particular mining (del Valle 2003).

This situation changed in the second half of the 18<sup>th</sup> century. Mines had to be dug deeper, and this required a significant increase in capital. The first attempt to address this involved state intervention operating through the existing private merchants. Bancos de plata (Silver Banks) were set up in 1755, and operated as follows. The merchants obtained easy credit from the authorities of New Spain. The funds for this easy credit in turn came from a form of special tax on intrastate commerce called Alcabala, and hence were from the Spanish crown. For a number of reasons and especially because of the ongoing problem of favoritism where powerful authorities favored some merchants, this system led to continuous contention and controversy.

To put an end to this situation and to the resulting difficulties that private capital was having exploiting the mines, in 1784 the Banco del Avío Minero was established. Its capital resources were again directly provided and owned by the Spanish crown. In this case, the crown obtained the money for the bank by taxing silver that was presented to be coined.

The establishment of this bank should not be seen as an isolated policy to assure the necessary capital to foster silver production. Rather, it was part of a many-faceted plan to develop the industry of silver mining in particular, but more broadly mining, the main economic activity of New Spain. At almost the same time, the new Mining Ordinances of 1783 were established, a set of laws to give a new legal structure to the extraction of silver. In 1793, the Real Academia de Minas was founded, “the first school of engineering

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<sup>15</sup> The Catholic church’s financing was mostly involved with agricultural activities.

in the Americas.” The Spanish Crown was deliberately trying to change the process where the exploitation of the mines in New Spain had been left to the individual efforts of small partnerships or private capitals, to one where it was a state controlled industry. As Howe (1949, 9) expresses this change, “The part played by the government was in general a passive one consisting in the broad permission granted to search for and work in the mines. With the passage of time the government was forced into a closer relation with the industry.”

The Banco del Avío Minero only functioned from 1784 to 1792 (even in some years it did not have regular activities). Among the reasons that it failed, the two key ones were the hostility that it faced from the powerful merchants and the corruption of its members. A further intent to finance development came later on, after Mexican independence.

When Mexico obtained its independence in 1821, it was very backward economically, because the Spanish crown has deliberately impeded the development of its possessions with measures such as barriers to intrastate commerce (alcabalas) and the prohibition of production of any manufactured goods. The war of independence not only caused extensive material destruction, but it also left the new country economically and politically unstable. Specifically, the cost of the war of the independence and the additional burden of the loans taken for reconstruction from British financiers from 1821 to 1825 left the new country heavily indebted. It defaulted in 1827 and then renegotiated the debt from 1831 to 1836 (Sandoval, 2005). Politically, a civil war between conservatives and liberals broke out very soon in the newly independent nation. This was soon followed by growing intervention from more powerful countries such as Spain, France, and the United States.

In its first years of independence, Mexico tried to encourage economic liberalism, allowing trade with all the countries of the world. The liberal policy of allowing

unrestricted imports largely destroyed the incipient Mexican textile industry. More generally in relation to the topic of this dissertation, under the liberal economic policy of the first years of independence, there certainly was no attempt to promote industry or development with public resources. Several members of the government opposed the free-trade policy because the main source of revenues for the state was taxing imports. These people considered as a better option to allow imports and to tax them and with these resources to encourage industrial development.

Finally in 1830 was established, by President Anastacio Bustamante, the second industrial development bank in the Americas, the Banco del Avío. Its most immediate goal was to revive the textile industry, but beyond that, its broad goal was to create a productive capitalist industrial sector. The funds of this bank would come from a tax of 20 percent on manufactured cotton imports.

During its 12 years of existence from 1830 to 1842, the bank carried out both the functions of a lender to companies at lower than market interest rates and of a provider of machinery and technical assistance (Potash 1953, 263), almost the same activities as the European industrial banks at the same time. The Foreign Trade Bank of Mexico (BANCOMEXT) did a review of the goals and activities of this early development bank: creating a source of capital accumulation through the taxation of imports...; 2) stimulating the creation of a Mexican capitalist sector by means of stock companies, which once formed would be financed by the government, through an institution that would be created for that purpose...; 3) bringing either from Europe or the United States the modern machinery necessary for the creation of the factories...; 4) bringing either from Europe or the United States the necessary technicians who would come to teach the Mexican students (BANCOMEXT 1966, 19, author's translation).

During its lifetime, this bank promoted not only the textile industry but also the iron and paper industries. The failure of this bank is attributable to a combination of

factors: the misallocation of resources by the authorities of the bank (favoring themselves - corruption), the political turmoil in which Mexico was still involved with the battle between the conservatives and liberals, the battle between the government and the Catholic Church, and finally the growing intervention into Mexico by foreign nations such as Spain, France, and the United States.



## CHAPTER 3

### MEXICO: THE EXPERIENCE OF NAFINSA (1934-2010)

#### 3.1 Introduction

In history, the process of industrialization in England did not require a strong relationship between banks and industry. Other nations, like Belgium, France, Germany, and Japan needed a stronger relationship to support their efforts to catch up with England. The association of banks and industry in some cases was carried out through private banks, while in other cases, this association had to be fostered by the state because the private banks did not have either the resources or the willingness for that relationship.<sup>16</sup>

This formula of developing institutions to mobilize finance for the purpose of promoting industrialization and development was successful, to differing degrees at different times, in a many countries. In other countries, however, in particular among those in the Third World, this strengthened finance instead increased the power of the elites and worsened the conditions of life of the common people. What was the case of Mexico? Did finance, either by private banks or government-sponsored banks, contribute to development? This question does not have a unique answer in all time periods, since both external factors and internal class struggle in Mexico have evolved differently at different times during the 20<sup>th</sup> century. To evaluate the contribution of industrial financing to the industrial and economic development of Mexico at any particular

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<sup>16</sup> Development banks are not only good at promoting industrialization in early stages of development. The existence of development banks like the Kredintaltant für Weidaruftban (KfW) in Germany, the Development Bank of Japan, and the Business Development Bank of Canada shows that they are also important in advanced economies.

time, the following aspects must be considered:

- 1) The evolution of the Mexican economy.
- 2) The government's policies to promote industrialization and economic growth.
- 3) The nature, structure, and procedures of the financing.
- 4) The role of NAFINSA, which was for decades the most important bank in Mexico concerned with industrial and economic development.

These aspects will be considered in relation to the development of NAFINSA throughout its entire history. Although the focus of this chapter is the relationship between NAFINSA and Mexican economic performance, in order to understand that, it is necessary to first discuss as background the structure of the Mexican economy from the Porfiriato (1876-1911) until 1934, the year in which NAFINSA was founded.

### 3.2 Economic Background 1: The Mexican Structure of Production and Financing During the Porfiriato Dictatorship, 1876 - 1911

The main characteristics of the Mexican structure of production during the Porfiriato were:

1) The Mexican economy enjoyed political stability under the dictatorship of President Porfirio Diaz (1876-1911), and it averaged a 3.3 percent rate of growth from 1877 to 1910. Internationally, this period was characterized by the existence of big monopolies and large-scale exports of both goods and capital. Mexico was inserted into the world markets via its exports of minerals and other products such as coffee and henequen, mostly to the US.<sup>17</sup> Foreign interests dominated these activities, as they also did the key industries of railroads and banking. The main source of revenue for the government was taxes on imports. In this period, Mexico had incipient industrialization in

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<sup>17</sup> Though Mexico was not a big exporter compared to other Latin American countries. In 1912, exports per capita were 11 dollars in Mexico, 62 in Argentina, and 65 in Cuba (see Knight 2010, 478).

beer, cement, textiles, glass, and railroads, among others. With strong protection by the government along with the increase of railroads in the country, these industries achieved a healthy initial growth. The vast majority of the population, however, was peasants, who had minimal participation in markets.

2) Financing was dominated by foreign banks. British capital was the first to arrive during the second French occupation (1861-1867). It established the first private bank in Mexico in 1864, Banco de Londres, México y Sudamérica. French capital came later, but soon became the most important. It founded the Banco Nacional Mexico (BANAMEX) in 1881 and the Banco Mercantil in 1882.<sup>18</sup> These banks merged in 1884. Hence, by the 1880s, the French were the main exporters of capital to Mexico, and had gained control of Mexican banking. The extent that this was true is indicated by the fact that the Banco Nacional de Mexico was a private bank that acted as a central bank and had special privileges such as to hold less required reserves, to be exempted from particular taxes, and to branch all over the country, privileges that made the creation of other banks in Mexico more difficult. For those reasons, some authors maintain that “[Mexican banking was dominated by a] small but energetic French colony...” (Ramírez 1986, 18).<sup>19</sup> French dominance in Mexican banking lasted until 1910, the end of this period.

3) Foreign banks generally only granted capital to the members of their own financial group. A first harmful result of this slow and unequal development of credit intermediaries was that it was very hard for Mexicans and hence Mexico to establish new companies. As Haber points out (1991, 566), most manufacturers simply could not obtain bank financing, and those that could only succeeded in obtaining short-term loans to cover working capital costs.

<sup>18</sup> There were other banks in Mexico, such as the Bank of Santa Eulalia and the Bank of Hidalgo founded in 1875 and the Banco Minero, the Banco of Chihuahua, and the Banco Mexicano de Chihuahua founded in 1883, but they were not as influential as the Banco de Londres and the Banco Nacional de Mexico. These two banks were the only ones with national acceptance and circulation.

<sup>19</sup> One of the explanations offered for why countries such as Germany and the United States industrialized faster than France is that French savings did not contribute to the capital formation in France but rather left the country. According to Cameron (1958, 5) “... From 1850 to 1914 between one-third and one-half of all French savings were channeled abroad in the form of foreign investment...”

Maurer (1999, 332 and 340) describes how banks such as BANAMEX, then the most important bank in Mexico, largely practiced 'insider lending' in which the directors of BANAMEX belonged to the boards of other industrial companies:

Banks adopted a strategy of making long-term loans to individuals and firms associated with their directors - 'insider lending' - in response to the scarcity of information that characterized the Porfiriato... [For example] Banamex already participated in the textile industry to some extent. It lent heavily and long-term to CIMSA, and provided working capital to the Compania Industrial de Atlixco cotton textile mill (CIASA) in Puebla. These were insider loans. Banamex owned part of CIMSA; the rest was held by Banamex shareholders. CIASA was connected to Banamex through two of its three board members and chief partners: Luis Barroso Arias, a prominent Banamex board member, and Agustin Garcin, who owned extensive interests in CIASA, CIMSA, and Banamex.

Similarly, these practices were also followed by smaller banks such as the Banco Mercantil de Veracruz and the Banco de Nuevo Leon.<sup>20</sup> Therefore, the conclusion was (Idem., 343):

When Porfirian banks made long-term loans to companies, they preferred to lend to their directors as individuals, who then used the funds to finance their particular businesses. When they lent directly to companies, they demanded personal guarantees from the managers.

4) There was a well-coordinated relationship among members of the government, capitalists, and bankers in order to establish profitable businesses. Companies received protection according to whether or not they had political connections with Porfirio Diaz's regime (Haber 2010, 421; Knight 2010, 477). It was not only as already mentioned that the government protected industries and that bankers largely restricted credit to members of their own group, but further that members of the government of the Porfiriato belonged to the boards of the biggest Mexican joint-stock companies, and that bankers in some cases served as official representatives of the Mexican government. The result of all of this was the early rise of big financial and productive groups that later on would dominate the Mexican economy.

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<sup>20</sup> Which later contributed to forming the powerful Monterrey group.

5) The incipient industrialization of Mexico greatly expanded the number of wage-laborers. Their organizations emerged first mostly in railroads, mining, and the textile industries. Unions were, of course, fiercely repressed, as were peasants by the expanding agricultural capitalists who were taking their land (Knight 2010, 486).

6) The Porfirian state was particularly openly supportive of the capitalists (Ceceña 1979, 50). Internationally, this was demonstrated by its open and strenuous efforts to attract FDI, and its treatment of foreign banks. Domestically, this was shown on the one hand by the government's initiatives to foster joint-stock companies and the necessary credit institutions, on the other by the existing repression of workers and peasants.

### 3.3 Economic Background 2: The Mexican Structure of Production and Financing in the Recuperation from the Revolution and the First Period of Mexican Development, 1911- 1940

The dictatorship of Porfirio Diaz was ended in 1911 by the Mexican political and economic revolution which had as main demands: 1) free voting and no reelection, and 2) return of the land that had been taken by the agricultural capitalists. There is a debate on what happened to Mexico's GDP during the Revolution. Haber (2010, 427) argues that GDP and industrial capacity were not damaged severely since revolutionary and government armies did not destroy companies, but rather only seized their revenues. Thus by 1921, the level of real GDP was higher than the level of 1910. On the another hand, FitzGerald (1979, 263) argues that "most of the initial capital bases for modern agriculture and industry laid under the Porfiriato were destroyed during the years of revolutionary violence between 1911 and 1924, and output in all branches fell."

Where there is a consensus is that the Revolution caused a lack of means of payment. Particularly relevant to this dissertation, the period that followed also led

to a precipitous drop in bank credit, which fell from 603 million pesos in 1910 to 342 million pesos in 1925,<sup>21</sup> and then to 245 in 1932 (see Solis 1970, 105 and 106 and also Ibarra, 1986, 230). Related to these points, only a few banks could survive during the Revolution because most could not recover the loans they had granted. Finally, there is also consensus that it was not the most progressive sectors of Emiliano Zapata and Francisco Villa which triumphed in the Revolution, but rather the petite bourgeoisie, which organized the postrevolutionary ruling political-military bureaucracy (Leal 1975, 50).

The country in the 1920s suffered extreme social, economic, and political inequality. As a result, the rate of growth of Mexican GDP averaged minus 1.03 percent from 1921 to 1933, and was quite volatile. In the immediate postrevolutionary recovery from 1921 to 1926, the Mexican GDP grew at a rate of 2.68 percent, but then from 1926 to 1932, the Mexican GDP growth rate collapsed to -3.81 percent. Although the effects of the world Great Depression affected the latter part of this period, the Mexican GDP had already started to slow down sharply in 1926. See Figure 3.1.

This economic downturn crippled the relaunching of the process of industrialization in two ways. First, there was a lack of capital available in the economy to build the necessary infrastructure. Second, the extensive poverty meant there was weak demand for domestic industrial products. Given these conditions, the new focus of the Mexican government's attempts to promote development from 1920 to 1940 was not (primarily) industrialization (as it became after 1940), including, as will be discussed, during the first six years of the national development bank NAFINSA after 1934. The four foci for development in this period were 1) the consolidation of the Mexican state, 2) initiatives to restore the financial system, 3) nationalization of key productive activities, and 4) the promise to carry out the land reform. Hence, the first postrevolutionary period of Mexi-

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<sup>21</sup> By the mid-1920s, the French dominance had weakened, to the benefit of other foreign banking interests (Marichal 2007, 83). In 1924, foreign banks collectively held 70 percent of the metallic money and 83 percent of the demand deposits (Cardero 1972, 732).

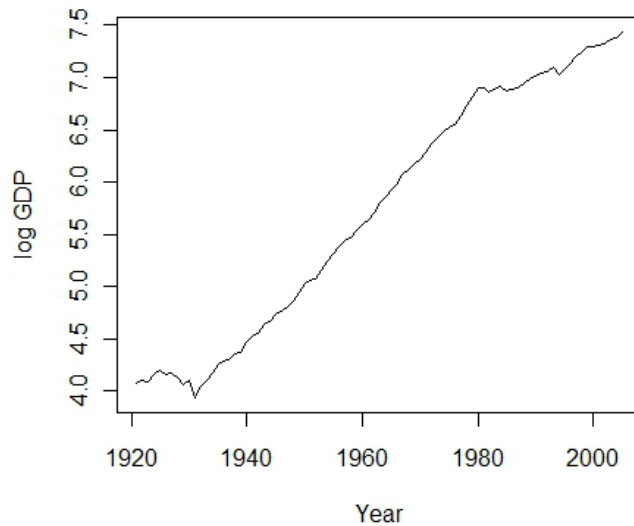


Figure 3.1 Log Mexican GDP from 1921 to 2006.

can development from 1920 to 1940 was characterized by the following government actions:

1) Pacifying the country after the armed revolution (that had started in 1910), the Cristero war<sup>22</sup> (1926 - 1929) and the three attempts to obtain the presidency through armed insurrection in the years 1923, 1927, and 1929. By the end of this period, an institutional mechanism for presidential succession had been developed, occurring through a powerful political party and not by disputes among commanders of the Mexican army. Some scholars call this the beginnings of the construction of the national state (see FitzGerald 1978, 264). This was a capitalist state, dominated by the petite bourgeoisie which had triumphed in the extended armed revolution. The state had an important degree of autonomy from international capital and fought its domination of agriculture and mining (Hamilton 1983, 3). Domestically, as discussed below, it worked to prevent the land reform, which was the greatest popular demand during and after the Revolution, and to establish a labor code to regulate the relations between capital and labor, a regulation that was necessary to promote the development of capitalist production.

<sup>22</sup> The Cristero war had as its objective to relax the strongest anticlerical provisions of the Constitution of 1917 and subsequent anticlerical legislation.

2) Putting into Mexican hands the main economic activities that had always been in foreign hands, such as minerals and agriculture (Meyer 2000). Furthermore, public investment in the 1920s though small was concentrated on roads, and there was a marked increase in economic and social spending later in the period under the presidency of Lázaro Cárdenas from 1934 to 1940 (Solís 1970, 10-11).

3) Creating new institutions and enacting new laws and reforms for reconstructing and promoting the financial system. The National Banking Commission and the Banco de Mexico, founded in 1924 and 1925, respectively, had the task of centralizing the issuing of money. By doing this, the state could then manage the national currency, exchange rates, and the interest rate. The General Law of Credit Institutions in 1924 and 1932 and the Banking Reform in 1931 established the currency issued by the central bank as the national currency and established reserve requirements for private banks to be held by the central bank.<sup>23</sup> Further, a goal of these acts of 1924, 1931, and 1932 was to enable the National Banking Commission and the Banco de Mexico to provide credit to the Mexican economy and in particular to restore the banks' liquidity. These points were important not only because previously money was entirely controlled by foreign banks, but also because the newly established institutions allowed Mexico to abandon the gold standard in 1931. In addition to this, other specific key institutions were founded to promote concrete sectors in the Mexican economy, such as the National Agricultural Credit Bank in 1926 under the presidency of Plutarco Elías Calles (1924 - 1928), the National Urban Mortgage and Public Works bank in 1933, and finally, the focal object of this chapter, Nacional Financiera (NAFINSA) in 1934.

4) Carrying out the land reform. Although it proceeded slowly from 1920 to 1934 in the face of government resistance as indicated above, it made a jump forward

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<sup>23</sup> When founded, the Banco de Mexico carried out the functions of both a central bank and a commercial bank. Given that, the consolidation of the Banco de Mexico as the sole issuer of legal tender gave it a major competitive advantage against other banks. To avoid the major struggle this would inevitably lead to, all commercial activities by the Banco de Mexico were ended in 1932 and ceded to BANAMEX. (Hamilton 1983, 11)



from 1934 to 1940 during the presidency of Lázaro Cárdenas. “...The land distributed during the Cárdenas regime was more than three times the amount distributed by the previous... presidents” (Ramírez 1986, 61).

5) Creating a stronger capitalist sector. In the first place, this involved the construction of infrastructure in the 1920s. However, beyond that and more immediately related to the topic of this dissertation, the creation of the Banco de Mexico strengthened the relationship between the government and the bankers (Del Ángel 2010, 640 and Bennett and Sharpe 1979, 41). Banco de Mexico held the reserves of the private banks, but it also granted credit to the private banks’ companies (Hamilton 1983, 8). A further very clear example of how the relationship of the capitalists and the state worked was the National Agricultural Credit Bank. In 1926 and 1927, it granted 17 million pesos to 1,000 thousand big Hacendados, including the ex-president Álvaro Obregón and the Defense Minister Joaquin Amaro, while at the same time it granted only two million pesos to 10,000 small farmers (see Hamilton 1983, 9).<sup>24</sup>

Table 3.1 gives a few indications of some overall changes across this period of recuperation from 1920 to 1940. Agriculture declined as indicated, in both employment and the value of output (despite its strong performance under Cárdenas from 1934 – 1940 as mentioned above, and further indicated below). Services increased employment significantly, but with little increase in the value of output. Industrialization was very slow, as measured by the minor increase in employment. Its value indeed went up by 1940, but an important part of that was the increased prices of raw materials in 1940 that resulted from the outbreak of WWII.

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<sup>24</sup> There were many cases of “the revolving door” where government officials later went to the private sector and used their government connections. One prominent example is Luis Montes de Oca who was Finance Minister and the Head Director of the Banco de Mexico and afterwards founded the Banco Internacional. A second similar case was Eduardo Suarez who was Finance Minister and afterwards Head Director of the Banco Comercial.

Table 3.1 Structure of the GDP and Employment in Mexico

Sector	1920 GDP	1920 Employment	1940 GDP	1940 Employment
Agriculture	23.3	70.5	20.2	65.4
Industry	13.1	12.9	19.4	13.7
Services	52.1	15.0	54.3	19.1
Mining	11.5	1.6	6.1	1.8

Adapted from source: Márquez 1997

### 3.4 The Foundation of NAFINSA (1934 - 1940)

While NAFINSA was founded in 1934, the first six years of its existence can almost be considered a “prehistory” of the development bank. As will be documented, it certainly had some effect on Mexican development in those years, but there is a debate as to how much. In any case, it certainly had much less effect than after it took on the role of industrial promoter in 1941, when one could say that its real history as a development bank began.

Reversing the draconian decline of the economy at -3.81 percent per year from 1926 to 1932 that was noted above, in this period (during the World Great Depression), the rate of economic growth in Mexico was 4.7 percent. See Figure 3.1. This was in the first place a result of the agricultural sector, and secondly of the small industrial sector. As was mention before, in this period, there was massive distribution of land compared with previous postrevolutionary years. Lázaro Cárdenas distributed 9.6 percent of Mexico’s surface area which was equivalent to 3 times more land than distributed by the previous postrevolutionary presidents combined. The sectoral composition of GDP was 20.2 percent in the primary sector, 25.9 percent for the secondary sector, and 54.5 for the tertiary sector from the period 1936 to 1940. These proportions were almost the same as from 1932 to 1936. It is worth noting that in the years from 1933 to 1936, which were still during the international Great Depression though after its worst years,

Mexico had continual growth. Scholars agree that this relatively fast recovery was driven by the expansion of public spending (Cárdenas 2010, 530) and a positive trade balance. After that, the following years in this period were characterized by instability.

Nacional Financiera, S.A., (NAFINSA) was founded in April of 1934 by President Abelardo L. Rodríguez with equal participation of public and private capital, although disbursements were made mostly by the state. Its supervisory board consisted of 7 members, 3 of them selected by the state and 4 selected by the private sector. According to Ares (2007, 8), this composition of the supervisory board brought credibility and trust from the business community. A counter argument would be that it was not just the “trust” from having 4 representatives but rather the influence and even control that the structure gave over the institution to the capitalist sector that was the key to the capitalists’ acceptance.<sup>25</sup>

NAFINSA had the following mandates: 1) to sell real estate in order to provide liquidity to the Mexican economy, 2) to develop capital markets, 3) to be a legal agent of the government to its domestic and foreign creditors, and 4) to be an investment promoter via the organization and the creation of companies and corporations (Villa 1976, 3). Yet NAFINSA’s main function until 1935 was to provide liquidity to the economy in order to promote the agricultural sector. As Mexico at that time did not allow private banks to hold any significant amounts of real estate (Blair 1964, 206), NAFINSA had to sell properties that had been frozen in the accounts of the Mexican credit institutions from the years of the Revolution until 1934.

NAFINSA data on the finance it provided to the economy divide it into three types: *Inversion en valores* (buying securities), *Crédito* (extending credit) and *Ávales* (bank guarantees). Figure 3.2 shows the division among these three components in this

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<sup>25</sup> Banco de Mexico was founded in the same way in 1925. 4 members of the supervisory board belonged to the private sector and 5 to the private sector (see Ortiz 1998, 16).

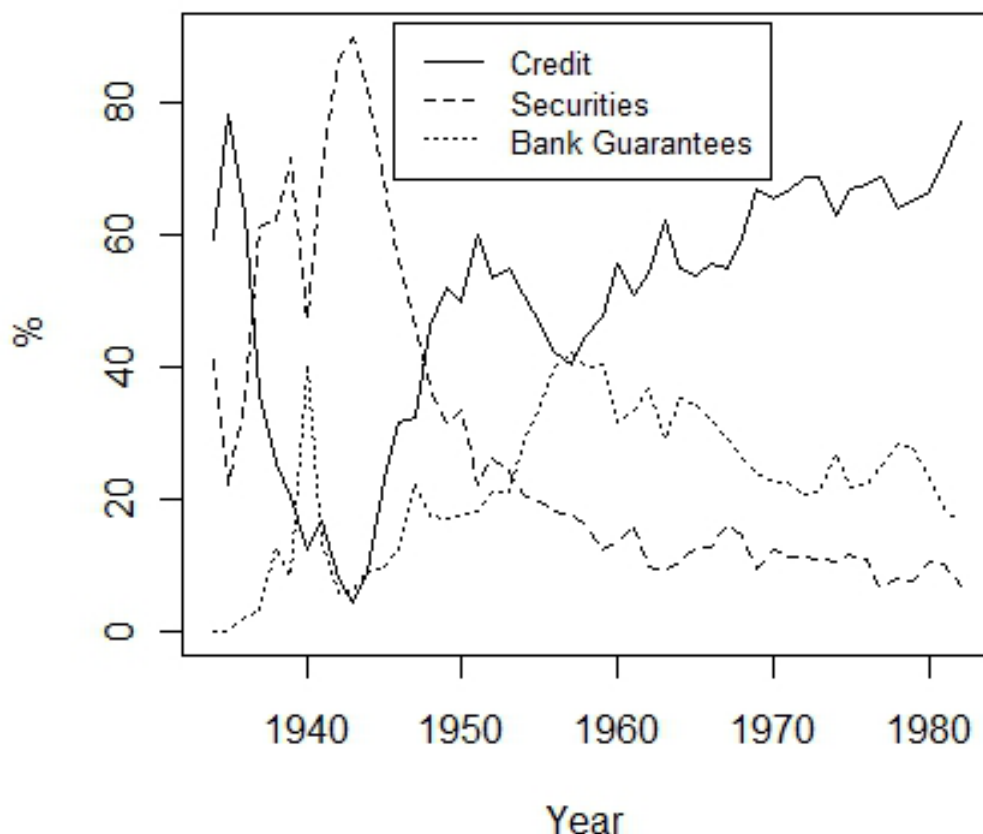


Figure 3.2 Credit, Securities, and Bank Guarantees as Percentage of NAFINSA's Total Financing

early period.<sup>26</sup> NAFINSA started granting credit, but over the 1930s and during WWII, it increasingly engaged in buying securities, in line with its mandate to work to develop the stock market.

There is a debate on the importance of NAFINSA to Mexican economic development in this period. The side that argues it was marginal, such as López (2009, 8) can point out that if one takes into consideration only total financing divided by GDP, NAFINSA's participation was minimal as it was less than 0.40 percent of GDP in the whole period. More directly relevant, its financing was generally under 3 percent of the financing of the total banking system (see Table 3.2).

<sup>26</sup> This figure will be referred back to later for considerations of the later periods that are also shown in it. These data were not provided in the same form after 1990.

Table 3.2 NAFINSA's Financing Divided by GDP, and by Total Bank Financing. Percent.

	1934	1935	1936	1937	1938	1939	1940
NAFINSA's total financing over GDP	0.38	0.25	0.25	0.18	0.16	0.15	0.24
NAFINSA's total financing over total financing of the banking system.	4.25	3.02	2.49	1.79	1.54	1.17	1.82

Adapted from Source: Villa 1976.

The other strong argument for the marginality of NAFINSA to Mexican development in this period is that President Lázaro Cárdenas had compromised with the agricultural sector (Villa 1976, 6), as a result of which NAFINSA even had to cede about a half of its capital to the Agricultural Credit Bank in 1935 (see Ares 2007, 208; Villa 1976, 4; López 2009, 8).

One argument to the contrary for NAFINSA's importance was its role in the development of the stock market, in line with its mandate as indicated above and as one sees some support for in Figure 3.2<sup>27</sup>, <sup>28</sup> Blair singles out (1964, 206 and 207):

At the time of NAFIN's creation, the securities market in Mexico was feeble. In 1934 the country's only stock exchange, the Bolsa de Valores in Mexico City, recorded a mere 4 million pesos in total transactions... Taking its function seriously, NAFIN bought and sold 2 million pesos worth of securities in 1935 and rapidly increased its annual transactions to a level of 44 million in 1937. In 1940, in an effort to stabilize a market ruffled by world events and the uncertainties of an election year, it made purchases and sales totaling nearly 73 million pesos

Besides, in a further effort to try to promote the incipient financial markets, NAFINSA issued its own securities in 1937 and by the end of the period that we are looking at in 1940, NAFINSA, with its varied experiences and the amount of securities it held, "...was clearly the most influential institution operating in the Mexican securities market (Blair 1964, 2007)

<sup>27</sup> The figure shows securities as a percent of NAFINSA's total finance, which does not directly speak to NAFINSA's share of the stock market.

<sup>28</sup> There of course is a current debate about whether developing a stock market (today) contributes to a country's growth and development.

In addition to its activity promoting the stock market, NAFINSA carried out a few other development-related activities. It constructed one hospital, it participated in the nationalization of some key industries such as electricity, and it gave minor support to activities in some industrial sectors such as steel, beer, tobacco, and paper (Ares 2007, 208). These activities did not have a great impact in promoting industrial activities in the Mexican economy during this period, but they are sometimes claimed to have established precedents and procedures that were to later strengthen its industrial development (López 2009, 5).

A balanced evaluation of the role of NAFINSA in this period appears to be that it had some but not an extremely strong influence on Mexico's development, that what it had was mostly on the stock market and to a lesser extent through the promotion of some companies, and that its influence was much less than it was to be for the following several decades.

### 3.5 Economic Background 3: The Mexican Structure of Production and Financing During the Industrialization Efforts, 1941 – 1981<sup>29</sup>

From 1941 until the debt crisis in 1982, Mexico promoted import substitution industrial activities. It is important to understand, however, that neither at that time nor in the subsequent neoliberal period that promoted exports did Mexico develop a long-term industrial policy, and consequently, external factors have always been a key in determining its specific policies (Guillén 2000, 36). It is worth noting that during the import substitution period, Mexico achieved high and sustained rates of economic growth; in contrast, during the neoliberal era, rates of growth were quite feeble.

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<sup>29</sup> As already indicated, Mexico greatly increased its industrialization efforts beginning in 1941. Since some of the data I want to support I argue goes back to the mid-1930s, I use it as presented, but 1941 remains the beginning of this period for our analysis. Similarly, a major shift in the approach to industrialization occurred with the debt crisis in 1982, so I end this period at 1981, but some of the data go to 1986 when the new approach becomes fairly consolidated.

A stylized fact about Latin America and the Great Depression is that a number of the more important economies responded out of necessity to the world downturn by initiating import substitution industrialization programs. There is a particular debate about if Mexico increased its import substitution then, and if that contributed to the recovery beginning in 1934 that is visible in Figure 3.1. Authors like Díaz Alejandro (2000, 140), Garrido (2002, 233), Bulmer–Thomas (2003, 206-208), and Márquez (1997, 313) argue that the recovery was led by import substitution, while Solís (1970, 99) and López (2009, 3) argue against that. In Table 3.1, we saw that measured by employment, the industrialization between 1920 and 1940 was quite weak, and I argued that the significant increase in the value of the output was largely a result of price increases that occurred only near the end of the period in 1940 as WWII began. I argued along with many authors that the recovery was driven primarily, though not exclusively, by the improved performance and increased output in agricultural under Cárdenas.

Regardless of one's position on the importance of the relatively small increased industrialization in the 1930s to the recovery then, there is much broader agreement that starting in the early 1940s, industrialization became the main factor in Mexican economic growth. This resulted from the following reasons: 1) the acceptance of the idea that key to promoting industrialization and development was using the state on a large scale to create and support private capitalist industrial enterprises, 2) exports (hence demand for Mexican industrial production) boomed especially starting in 1942 during WWII because the need by the United States and England for a lot of manufactured goods and minerals, 3) with the end of the conflict with the US over oil expropriation, the door was opened to Mexico for credits granted by the Ex-Im bank in 1941,<sup>30</sup> and also to increased FDI

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<sup>30</sup> The relationship between Mexico and the Ex-Im (Export - Import) Bank of the United States started in 1941. According to Green (1978, 3) and Villa (1976, 104), the main purpose of the Ex-Im Bank was to encouraged US exports and not the development of poor countries. Subsequently, from 1941 until the end of WWII, the Ex-Im Bank worked to maintain a trade between some goods that Mexico was able to produce and the US needed, and some US products that the US wanted to have promoted.

from the US,<sup>31</sup> and 4) spending in industrial promotion as a percent of public investment grew from 1943 until 1981; in 1950, it became more important than agricultural promotion and, at the end of the 1950s, it became more important than the spending carried out in communication and transports (see Figure 3.3).

With this background as to why industrialization took off after 1940, we can now look at the main characteristic of the Mexican economy from 1940 to 1981. Of central importance to the issue of industrialization, in particular in comparison to the period that followed it, were the two points that it was largely (not exclusively) inward looking industrialization, and that it rested on a high participation by the state (see Figure 3.1). The key economic and financial characteristics of the period were:

1) Mexico grew, not without fluctuations, at an average rate of 6.0 percent from 1934 to 1981. During this period, it had three major expansions (defined as four continuous

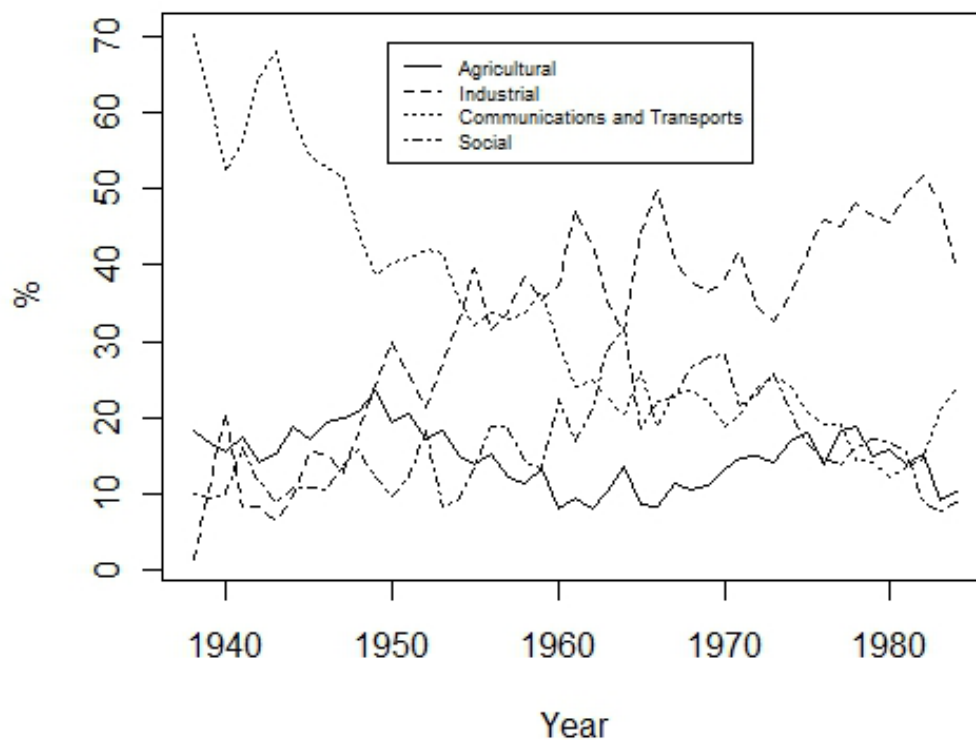


Figure 3.3 Mexican Public Investment by Sector. Percentages Out the Total

<sup>31</sup> This remained fairly low at this time, however, because of the strong protection.



years of growth); from 1933 to 1936, from 1954 to 1957, and from 1978 to 1981. Similarly it had three major downturns (defined to need three continuous years); from 1947 to 1949, from 1965 to 1967, and from 1974 to 1977.

2) The agriculture sector grew steadily and brought in foreign exchange that could be used by the industrial sector, until it reached its peak in 1965. Since then, the rate of growth of agriculture has declined and Mexico now imports several basic products for the population's nourishment, for example wheat, rice, and beans (Yúnez 2010, 734), draining foreign exchange that could otherwise be used by industry.

3) The sectoral composition of the Mexican GDP has continually shifted in favor of industry and services. The participation of the primary sector declined from 22.4 percent during the period 1932-1936 to 8.8 percent during the period 1977-1981. Conversely, over the same span of time, industry increased from 23.2 percent to 32.7 percent and services from 54.4 percent to 58.6 (Márquez 2010, 558). This change in the sectoral composition of the GDP caused massive movements of people from the countryside to the cities. The urban population was 33.5 percent in 1930 and 66.3 percent in 1980. In this process, Mexico City received a disproportionately large proportion of the migrants from other parts of the country, having 1,644,921 inhabitants in 1940 and 9,623,151 inhabitants already in 1970.

4) Mexican exports were directed almost entirely to the US, reaching more than 80 percent during WWII and the Korean War. The Balance of Trade was almost in balance until 1956 and 1957, after which Mexico has had recurrent deficits.

5) The rate of Gross Fixed Capital Formation (GFKF) grew steadily<sup>32</sup> from 8.6 percent in 1940 to 22.63 percent in 1980. The participation of the state was nearly 40 percent in the whole period, and its main concern was to promote industry. As FitzGerald (1978, 272) points out, one cannot make a case for the conservative argument that this caused a crowding out process, since private and public investment moved together.

<sup>32</sup> Except for a short contraction from 1976 to 1978.

6) At least from the end of WWII onward, the import substitution model was central to Mexico's approach to industrialization and development. This model was based on import licenses and other barriers to (unregulated) trade. There was a close relationship between the business sector (both financial and industrial) and the state (both during the import substitution period being discussed here, and the subsequent export promotion during the neoliberal period). The structure of production had the foreign companies, which came via FDI, at the top, and was dominated by the high technology companies. National companies commercialized the products of foreign high tech companies and produced some intermediate and nondurable goods. Also, there were state-owned companies that provided basic productive intermediate products such as steel, electricity, oil, and infrastructure.

7) Urban and rural workers were organized into massive unions such as the Peasant National Confederation (Confederacion Nacional Campesina) and Workers National Confederation (Confederacion Nacional de Trabajadores) that were instruments of support for the government. Dissidents existed, such as in the cases of the railroads in the 1950s and electricity in the 1970s, but they were at a minimum highly persecuted, and generally over time suppressed. The goal of the official unions was to provide some social services to their members (Leal 1975, 55), such as a health system (Villarespe 2001, 35), housing and education, and to achieve higher wages. However, the benefits of national growth consistently went more to the capitalists than to the workers, as profits almost always grew faster than wages. Manufacturing wages were stagnant during the 1940s, but then did expand in the 1950s, 1960s, and 1970s (Valle and Martinez, 2011). As wages depend upon productivity and income distribution and the latter worsened since 1950, it can be said that the increase in wages was due to the increase of productivity. This phenomenon provoked the "... the generating [of] large profits for subsequent reinvestment, although the average real wage rate rose steadily as labor shifted from

agriculture to industry...” (FitzGerald 1978, 265).

8) National companies were not at the top in standards of international productivity, but they were the most favored during this period (even more than the workers and peasants that were organized by the government). In so doing, Mexican state tried to protect national companies from international competition via barriers to trade. For example, Mexico signed a trade agreement with the USA in 1943 which reduced trade tariffs (López and Zabudovsky 2010; Moreno-Brid and Ros 2010), yet the following year, the Mexican state tried to put the agreement back in order to promote the creation of a nascent capitalist class. Afterward, import tariffs were established from 1944 to 1947. In the same vain, Mexico rejected the GATT in 1947, and later put an end to the US trade agreement in 1949<sup>33</sup> (López and Zabudovsky 2010).<sup>34</sup>

9) Total financing by the banking sector was 27.4 percent of the GDP from 1934 to 1981, low if it is compared with other countries such as Argentina and Brazil (Del Ángel 2010, 10). This average by itself, however, hides the radical change in the amount of financing over the period. Starting from 9.0 percent in 1934, it grew fairly steadily to 19.4 by 1943 just after the beginning of the period we are looking at in this section. It then rose and fell repeatedly over the next 14 years, ending up with very little net change at 18.8 in 1957. It then grew strongly and steadily to 43.8 in 1973, after which it again stagnated over the 1970s to end up at 48.9 at the end of this period in 1981. As one can see from Figure 3.4, private banks provided little more than the single development bank,<sup>35</sup> NAFINSA, and the average contribution over the period of the private sector at 13.3 percent of the GDP was likewise under half the 27.4 percent total just noted.

Further, these private resources were granted mainly to companies of their bank’s group

<sup>33</sup> One sector of the capitalist class that attempted to encourage protection was the small business group called Cámara Nacional de la Industria de la Transformación (CANACINTRA).

<sup>34</sup> Questions arose about this way of encouraging industrialization whether or not the import substitution model was taken consciously as heterodox way of searching economic of growth.

<sup>35</sup> In addition to the private banks and the development banks, there was foreign finance via loans by the World Bank and the Ex-Im Bank of the US.

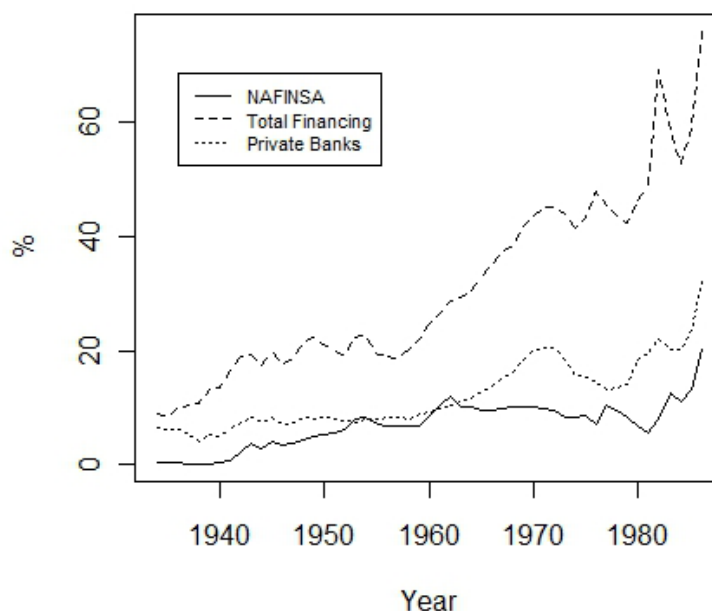


Figure 3.4 Total Financing in Mexico from 1934 to 1984. Percent of GDP

and to the government, thus constituting the same problem of insider lending discussed above for the period 50 years earlier.

### 3.6 NAFINSA as an Industrial Promoter (1941-1947)

For Mexico, this period was characterized by economic growth and inflation. The rate of economic growth was 5.6 percent. As previously indicated, four conditions enabled Mexico to start industrialization:

- 1) There were favorable external conditions caused by WWII that supported industrialization in Mexico. The United States was demanding a lot of raw materials and manufactured goods, therefore a trade agreement was negotiated between the US and Mexico in 1941. This agreement provided for a stable provision of commodities with a fixed exchange rate (Ceceña 1979, 189 ). Mexican exports therefore boomed, particularly in 1942 and 1943. Beyond the positive trade balance, particularly important was the part of the agreement that allowed the import of certain industrial equipment that before had been restricted (Ares 2005, 11).

2) There were taxes on imports and exports that were a great source of revenue for the Mexican government (Bueno 1972, 13).

3) There was foreign credit available for Mexico,<sup>36</sup> and also FDI. The country had been largely excluded from such capital markets for most of the 19<sup>th</sup> and early 20<sup>th</sup> century. In addition to the usual cheap labor, the attraction for FDI was that, notwithstanding its other protectionist measures, Mexico allowed the free remittance abroad of profits (Barking 1975, 70).

4) Surpluses generated in the agricultural sector made it possible to obtain the necessary imports to build the industrial sector.

In addition to these conditions, some people (Ares 2007, 10) highlight the political aspect with the presidency of Manuel Ávila Camacho who worked to bypass the existing policies that favored the agricultural sector in order to institute policies that favored the industrial capitalist sector. However, it seems more plausible that the ideological push for industrialization came from the then world-wide developing conviction that industrialization was the key to development, rather than from the individual convictions of the president. This desired goal was then enabled by the existing external conditions such as the positive trade balance and the increased access to capital markets just discussed. It took the shape of state-promoted industrialization under the conviction that the need for the industrialization to be rapid could only be achieved by the extensive resources that the state could mobilize being used to compliment and support the private sector (Villa 1976, 10).

Notwithstanding that there was a strong participation of the state in this period, it is important to note that Mexico has never had an industrial policy for long-term projects. National development has been put forward as a general strategy without

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<sup>36</sup> In this period, there were four agreements on foreign debt: i) a 1941 agreement on land claims, ii) the 1942 Zevada-Cooke agreement on claims concerning oil expropriation, iii) a Direct Debt agreement in 1942 on bonds whose debt service had been suspended during the armed Revolution and iv) an agreement in 1946 on debt concerning the railroads (see Ceceña 1979, 199-201).

comprehensive well-coordinated supporting policies. Villa (1976, 15 and 26) points out four mechanisms through which the government can promote industrialization which are 1) protection, 2) fiscal policies, 3) promotion and financial support, and 4) technical assistance and educational support. In the period that it is being considered, the only important fiscal policy, of taxing exports, was not being used to give the government revenue in order to support the generation of market demand, but rather as simple protectionism. While this was important, by far the most important industrialization and development policies were those of financial support and promotion. This was very clear in the redefinition of the functions of NAFINSA that were established under a new law in 1940 (see Aubey 1966, 40 and Villa 1976, 9):

1. Oversee and regulate the national securities and long-term credit market;
2. Promote the investment of capital in all categories of enterprises in the country;
3. Act as an institution of support for investment companies when they issued credit guaranteed by securities;
4. Oversee and direct the operation of the stock exchange;
5. Act as a finance or investment company;
6. Act as a fiduciary, especially of the federal government and its dependencies;
7. Act as the agent and adviser of the federal government, of the states, municipalities, and official dependencies in the issuance, recall, conversion, and all other transactions of public securities.
8. Be a legal depository for all classes of securities.

Hence, developing the stock market, being the legal agent of the government to its domestic and foreign creditors, and financially promoting industrialization were NAFINSA's main functions. As a participant in developing the stock market, it fulfilled its role in 1941 by issuing ten different kinds of bonds for various states of Mexico or state-owned companies. Also, NAFINSA issued its own securities such as Certifica-

dos de Participacion (1941) and Titulos Financieros (1941),<sup>37</sup> where the latter were denominated in dollars. As the legal agent of the government, NAFINSA negotiated the first loans granted by the Ex-Im Bank of the United States for an amount of 30 million dollars, which were used to build roads.

However, its main function was to ensure that incipient industries had sufficient finance when the private sector was unwilling to provide it. From 1940 to 1946, this took the form of investment in securities, which increased 56-fold. Figure 3.2 shows the tremendous increase in securities as a percent of NAFINSA's total financing over this period, from 50% to 90%. Table 3.3 gives the absolute levels of NAFINSA's financing via securities and credit over this period. Again, one can see that at this time, NAFINSA granted resources primarily via security investments, and that the role of credit only became important in this period after 1945.

The amount of this expansion of securities was such that there was also a tremendous expansion of NAFINSA's total financing over these years, as illustrated by Table 3.4 which summarizes the same two elements as Table 3.2: 1) NAFINSA's total financing over GDP, and 2) NAFINSA's total financing over total financing of the banking system. As can be seen, both aspects are markedly greater than in the previous period before this new definition of NAFINSA's responsibilities was created. Further, both aspects increased steadily from its redefinition until the end of the war in 1945, and then largely leveled out for the following 2 years. By 1945, NAFINSA represented an impor-

Table 3.3 NAFINSA Distribution of Total Financing

	1941	1942	1943	1944	1945	1946	1947
Credit	16.53	8.02	4.19	8.81	22.72	31.38	32.18
Securities	70.08	86.38	89.59	82.13	62.72	56.31	45.73

Adapted from Source: Villa 1976.

<sup>37</sup> Both securities were callable.

Table 3.4 Total NAFINSA Financing. Percentage of GDP and the Banking System.

	1941	1942	1943	1944	1945	1946	1947
Total financing over GDP	0.52	2.28	3.63	2.87	3.9	3.35	3.66
Total financing over total financing of the banking system.	3.15	12.0	18.71	16.59	19.68	19.08	19.75

tant amount of total bank financing, going from less than one thirtieth to almost one fifth in 4 years, and even became a noticeable part of the GDP.

Thus NAFINSA financing contributed to the development of many industrial companies such as Nueva Compania Eléctrica of Chapala, S.A., (electricity), Compañía Industrial Atenquique, S.A., (paper), Vidrio, S.A., (glass), Banco Cinematográfico, S.A., (films), Altos Hornos de México, S.A., (steel). Cementos Oaxaca, S.A., (cement), Guanos y Fertilizantes de México, S.A., (fertilizers), Carbonífera Unidad de Palau, S.A., (coal), Cobre de Mexico, S.A., (copper), Empacadoras de Calidad S.A.,(packing), Cementos Portland Moctezuma, S.A., (cement), Banco Cinematográfico, S.A., (films), Cementos Portland del Bajío, S.A., (cement), and Industria Eléctrica de Mexico, S.A., (electricity). Table 3. 5 shows some of the companies that NAFINSA helped to create during this period. In 1945 NAFINSA had stocks in 35 companies, and it was the major stockholder in 5 (Bennet and Sharpe 1979, 46).

The degree of participation in each company differed greatly, from 100 percent in Guanos y Fertilizantes de México, S.A. to 7 percent in Compañía Industrial Atenquique, and the industries supported were quite diverse. This diversity which often was quite arbitrary highlights the assertion I made above that Mexico had no well-formulated industrial policy.

In some cases, Mexican capitalists tried to exploit the opportunities offered by the US's declining exports of intermediate goods to Mexico, such as the case of steel. Altos Hornos de Mexico was a project started by Mexican capitalists because of the



Table 3.5 NAFINSA's Contribution in the Creation of Companies in 1945.<sup>38</sup>

Year of foundation	Companies' name	Participation
1940	Nueva Compañía Eléctrica Chapala, S.A.	69 % of total liabilities
1941	Compañía Industrial Atenquique, S.A.	7 % of the social capital. 100 % of total liabilities
1941	Vidrio Neutro, S.A.	100 of total liabilities
1941	Banco Cinematográfico	20 % of the social capital
1942	Altos Hornos de México, S.A.	57 % of the social capital
1942	Cementos Oaxaca, S.A.	50 % of the social capital
1943	Guanos y Fertilizantes de México, S.A.	The totality of the social capital
1943	Carbonífera Unidad de Palau, S.A.	20 % of the social capital
1943	Cobre de México, S.A.	45 % of the social capital
1943	Cementos Portland Moctezuma, S.A.	40 % of the social capital
1944	Empacadoras de Calidad, S.A.	50 % of the social capital
1944	Cementos Portland del Bajío, S.A.	19 % of the social capital
1945	Industria Eléctrica de Mexico, S.A.	30 % the social capital

declining steel exports to Mexico from the US. However, the project ended up being so costly that the State had to intervene to make the creation of this company<sup>39</sup> possible. In other companies, NAFINSA only supplied credit, as for example was the case for Celanese Mexicana S.A. (textile).

The case of Celanese is an illustrative example of how NAFINSA interacted in its work with private corporations and private banks to promote private corporations. When imports of synthetic textile fibers from Italy and Japan were cut off because of the war, the idea was to promote domestic production. NAFINSA found a partner in the Celanese Corporation of America, which on initiating the operations of Celanese Mexicana S.A., on August 5, 1944, became the first large U.S. company to enter Mexico

<sup>38</sup> Capital must be understood as the total shares issued by each company.

<sup>39</sup> The creation of Altos Hornos was a success. In 1944, Altos Hornos produced 3.4 percent of the national steel production. By the time of 1948, it produced 33 percent of the national production (Ramírez 1986, 67).

since 1938. In addition to a 15 million pesos credit from NAFINSA, BANAMEX, the largest private bank in Mexico, financed the venture (Celanese, 2010). By 1970, Celanese had become the eleventh biggest company in Mexico, and the major stockholder was BANAMEX.

### 3.7. NAFINSA During the Post-WWI Period of Stable Development

(1948-1970)<sup>40</sup>

This period had a high rate of economic growth in Mexico as a result of the outstanding performance of the world economy. This performance occurred after WWII with the expansion of international production and trade led by the US. This process of growth was distributed unevenly between different countries, with Western Europe and Japan benefiting the most. Underdeveloped countries also benefited from these decades of growth for two reasons: 1) the large demand for raw materials and 2) large amounts of FDI and other transfers of capital.

During this time, the Mexican economy grew at about 6 percent per year for almost the entire period (see the Figure 3.1), GDP per capita almost doubled, and there was low inflation and a stable exchange rate. This growth was called the Mexican miracle, or less ostentatiously, stable development. During this span of time, the health and university systems were built, representing the compromise between the government and the official unions. Manufacturing wages per hour rose steadily, which can be attributed with certainty to the increase in productivity since income distribution worsened. The sectoral composition of GDP finally shifted decisively against agriculture, with 13.6 percent of GDP in the primary sector, 30.8 percent in the secondary, and 55.7 percent in the tertiary in the period from 1962 to 1968. Mexico's exports were mainly agricultural

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<sup>40</sup> This period is appropriately referred to as one of stable development by comparison with any other period of such length, but there were of course some instabilities such as the devaluation of 1954 and the subsequent high inflation until 1958.

products and minerals. Protectionist licenses to import and tariffs continued to be used to promote industrialization, since 1944 and 1947, respectively. Mexico continued to solicit transnationals through the quartet of cheap labor, free remittance of profits, subsidies in basic inputs, and captive markets. Subsequently, much FDI arrived that contributed to the shaping of the Mexican capitalist sector. This included a temporary reversal of the decline of the capitalist agricultural sector with an increase of exports of primary products, mainly maize, due to the Green revolution, until the mid-1960s (Garrido 2002, 5).

In this period, the role assigned to NAFINSA changed with respect to the previous period (1941-1947). Some people argue that the reason for this change was that the industrial capitalist sector had become hostile to NAFINSA because they thought that the participation of NAFINSA in Mexico's industrialization had become too big, creating crowding out effects. However, this argument is inconsistent with the data since private investment moved together with public investment (see Figure 3.5). In addition, public investment grew slower than private investment over the 30-year period from 1940 to 1970 except for the 10-year period from 1955 to 1965. The increases in private investment were 453, 36.2, 42.9, and 80.5 percent from 1940 - 1955, 1955 - 1960, 1960 - 1965, and 1965 - 1970, respectively. The increases in public investment in the same periods were 165.8, 43.7, 70.2, and 52.6 percent. Finally, the public sector was investing in either infrastructure or basic industries that were not as profitable as the industries that the private sector was investing in. Thus, concern with crowding out is not a convincing argument.

An alternate more plausible hypothesis for the change of NAFINSA's functions is that a number of difficulties were identified in the Mexican structure of production. The incipient industrialization had shown problems associated with transport (railroads) and communications. Problems such as irrigation to satisfy the rate of growth in the agricultural sector and problems in the development of basic industries like oil

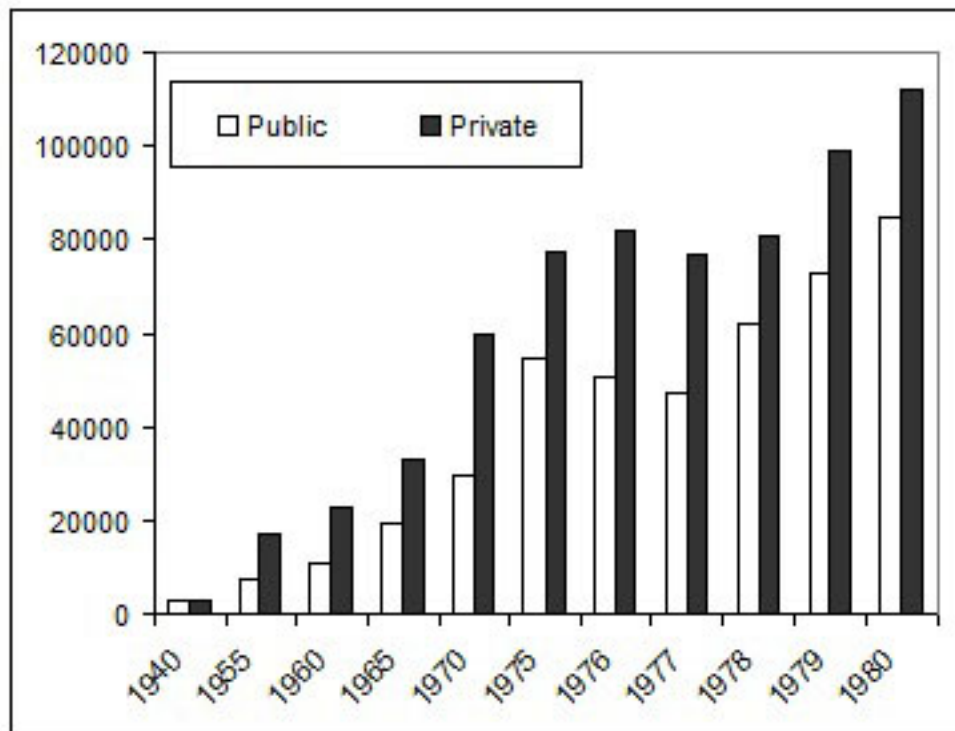


Figure 3.5 Public and Private Investment in Mexico. Millions of pesos.

and electricity existed. Therefore, as opposed to the previous approach of pumping finance into various industries, what was needed now was that the state had to provide infrastructure and basic inputs to promote further industrial progress. Aubey describes this situation:

First, the heavy emphasis on manufacturing industries, resulting in their rapid development, caused certain economic bottlenecks. A shortage of transportation facilities arose, as well as shortages in fuel oil, electric energy and materials. These shortages, among other things, caused a decrease in the rate of manufacturing production (Aubey 1961,45).

The Organic Law of December 1947 established that NAFINSA was to play a role in supporting the industrialization of Mexico by the private sector, but greatly reduce its role in directing the industrialization through its financing. Given that, almost all the resources of NAFINSA were assigned to finance infrastructure using credit, and its entrepreneurial role and its securities' purchases were sharply scaled down. The

aforementioned aspects are depicted in Figure 3.2 and in Table 3.6. Figure 3.2 shows how the role of investment in securities decreased sharply in this period with the adoption of the new policies in 1947 and continued to fall at a declining rate until the early 1960s. Table 3.6 illustrates how infrastructure grew to be main recipient of NAFINSA's financing, again growing over the whole period and ending at over 70 percent.

Consequently, NAFINSA played a major role in financing Mexican development in this period. If we look back at the part of Figure 3.4 for this period, we see that soon after its 1947 redefinition, NAFINSA was by itself providing almost as much financing as all the private banks,<sup>41</sup> and it continued to do so until the mid-1960s when the total from all private banks again outgrew that from NAFINSA. For the whole period 1948 – 1970, it provided 79.2 percent of the resources provided by all the private banks. The absolute magnitude of its contribution in this period was 8.1 percent of the GDP. Its share of total financing can be seen in Table 3.7 to have peaked in 1955, during the 1954 – 1957 strongest years of growth of the Mexican miracle.

Although as has been indicated NAFINSA in this period had mostly transferred its finance to infrastructure, its entrepreneurial role had not entirely ceased. NAFINSA now was involved with only a few companies, but they were among the biggest in Mexico. Some of the companies that NAFINSA supported in this period were Diesel

Table 3.6 Division of the Total NAFINSA Financing

Activities	1945	1947	1953	1958	1963	1964	1968	1970
Infrastructure	7.6	28.5	47.3	48.6	61.4	64.9	72.1	70.9
Industry	92.4	71.5	27.3	39.9	30	25.6	23.8	29
Basic	60.4	27.4	12.6	14.0	10	7.3	7.5	7.4
Other industries	32	44.1	14.9	25.9	15.7	18.3	16.3	21.6
Other activities	-	-	14.9	11.5	8.6	9.5	1.6	.1

<sup>41</sup> It actually surpassed the contribution from all the private banks in 1953 and at the beginnings of the 1960s. The first case was probably due to the decline in total Mexican economic activity that year while the second one was a result of the major support by NAFINSA then for electricity, and transportation and communications.

Table 3.7 NAFINSA Financing to Industrial Activities as Percentage of the Total Banking Financing

Year	%	Year	%	Year	%
1942	4.8	1953	40.9	1964	40.3
1943	12.3	1954	45.1	1965	38.0
1944	15.0	1955	50.0	1966	38.4
1945	24.0	1956	48.9	1967	35.7
1946	23.9	1957	46.6	1968	35.6
1947	26.7	1958	47.2	1969	32.1
1948	28.3	1959	43.5	1970	29.7
1949	33.1	1960	45.9	1971	31.7
1950	33.2	1961	44.7	1972	31.3
1951	30.9	1962	41.2	1973	31.1
1952	36.4	1963	40.7	1974	36.4

Nacional, S.A. (automobile), Metalúrgica Peñoles, S.A. (mining), Constructora Nacional de Carros de Ferrocarril, S.A., (railroad cars), Fertilizantes Monclova, S.A., (fertilizers), and Tubos de Acero, S.A., (steel).

The case of Diesel Nacional (DINA) is worth noting, as another example of the type of relationship between the government and the private sector noted above that permeated the Mexican economy. One of the cofounders of DINA was Luis Montes de Oca who had been director of the Mexican Central Bank, Banco de Mexico, and then had launched a project to found his own bank, Banco Internacional. When this project turned out to be beyond the resources of Montes de Oca and the other capitalists working with him, NAFINSA rescued the project and obtained 85 percent of the total stocks of this company. By 1958, NAFINSA held 100 percent of the capital of this company (Bennet and Sharpe 1979, 50 and 51).

In some cases, NAFINSA was not interested in owning shares of companies itself, but did want the companies to be under “Mexican control.” This happened for example in the branches of mining, electricity, food, tobacco, automobile, and

aluminum. In this case, it was made mandatory that 51 percent of the capital be Mexican. Sometimes, private Mexican capital was not willing to invest in such a company, and then, NAFINSA had to act as an investor of last resort (Ibid., 1979, 54).

The link of NAFINSA to productive enterprises went beyond financial support. In addition to being on the board of directors of the Central Bank, NAFINSA's president was on the board of directors of the country's largest companies such “. . . as the steel company, the telephone company, the nationalized petroleum company, and key corporations in textiles, cellulose and paper, coke and coal, light and power, electrical apparatus, automotive assembly, and railroad car manufacture . . .” (Blair 1964, 198). In addition to this “. . . NAFINSA personnel were on the boards of dozens of companies in the public and private sector . . .” (Ibid., 198). While on the one hand their presence could offer the enterprises influence with NAFINSA and hence possible preferential access to credits, it was also a channel through which NAFINSA's technical personnel made their ideas felt on the enterprises.

These companies were involved mainly with basic industries. NAFINSA could finance big companies because of its good financial situation, obtaining resources in two ways: 1) issuing securities and 2) obtaining loans from the World Bank and the Inter American Development Bank. NAFINSA had great acceptance for its *Certificados de Participacion* in 1953, but there was some concern that these were only highly liquid short-term securities and so the following year, they stopped issuing them for 10 years. Instead, they issued other less liquid securities such as *Certificados de Co-propiedad Industrial*. However, in this period, NAFINSA did not play the important role it had in the previous period in the further development of the stock market (Villa 1976, 113). Not only was the stock market now larger, but as one can see from Table 3.8, the percentage of securities in NAFINSA's total resources dropped 19.7 percent from 1952 to 1969. This was more than replaced by the increase in external financing which rose 58.8 percent,

a major shift in the structure of NAFINSA's resources.

While this period had been the best in the 20<sup>th</sup> century for the growth and development of Mexico, by its end, several factors were developing which were to undermine the Mexican economy in the period that followed, and in fact up to the present. These developments in turn were to lead to economic policy changes,<sup>42</sup> including in the conduct of NAFINSA.

The fundamental economic developments by the end of this period that undermined the continued relatively strong performance of the Mexican economy were the following factors:

1) The decline of the agricultural sector due to the incomplete land reform and the specialization in a very limited number of products. The most productive land was held by a very few owners, while the vast majority of peasants could not produce enough for the reproduction of their families. Quoting Eckstein, Barkin (1975,66) points out:

In agriculture, the agrarian reform provided a stable institutional framework within which most beneficiaries (about 90 percent of the 2.8 million) received land which, though, did not produce enough income to support a family. At the same time, however, public agricultural development policy deliberately enriched a relatively small number of people who worked to develop a capital-intensive agriculture which could incorporate important advances in agricultural

Table 3.8 NAFINSA's Source of Resources. Percent

Source	1952	1969
Capital and reserves	4.4	4.2
Securities Issued	29.5	23.7
External financing	23.1	36.7
Other	43.0	35.5
Total	100	100

<sup>42</sup> The changes in the economy made policy changes necessary, but there is no intended implication here that the changes that were made, and in particular the adoption of neoliberal policies, were the best policies that could have been adopted for the growth and development of Mexico under the new conditions.



technology, the extension of irrigation, agricultural credit facilities, and price support programs. As a result, 3 percent of the farms (some 79,000 units out of a total of 2.5 million) produced 55 percent of all agricultural produce in 1960 and accounted for 80 percent of the increase in the value of production in the 1950s.

2) The first stage of import substitution, nondurable goods, was carried out successfully by the 1960s. However, the substitution of intermediate and capital goods was more difficult. In 1950, capital imports were 35.3 percent while by 1968, they had climbed to 46.3 percent. It is therefore obvious that import substitution was not happening in these sectors, notwithstanding that NAFINSA (1971,15) pointed out that there had been improvements in the sufficiency coefficients<sup>43</sup> to 93.4 percent in steel, 100 percent in electrolytic copper, 98.5 percent in cement and sulfuric acid, 100 percent in paper, 80.3 percent in fertilizers, 98.3 percent in sugar, 86.7 percent in artificial fibers, and 86.7 percent in motor vehicles, among others. Scholars claim that the failure to (sufficiently) develop the domestic production of intermediate and capital goods resulted primarily from two factors. The first was the continually overvalued exchange rate that promoted cheap imports for national capitalists (Reynolds 1977, 1004). The second was the presence of many foreign companies in the most dynamic sectors of the manufacturing industries, whose production processes depended on imported technology, which made the substitution of Mexican capitals goods impossible (FitzGerald 1978, 269).

3) The presence of many foreign companies (the majority from the United States) in the most dynamic sectors of the Mexican economy had other consequences beyond the one just noted. These companies operated with backward technologies in international terms, but by operating in oligopolistic markets and under the protective system of public subsidies, they could achieve higher profits than average in the Mexican economy (Garrido 2002, 242).<sup>44</sup> In addition, the foreign companies consistently remitted

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<sup>43</sup> The sufficiency coefficient is the percentage of a product (such as steel) used by a country that is produced domestically.

large profits to their countries of origin.

4) The Mexican structure of production was dominated by groups as indicated before, involving strong narrowly focused relations between industry and banks. The relationship was expressed in two ways: companies that owned banks, and banks that owned companies. There was a discussion about which of these relationships was more important. FitzGerald argued that both groups were powerful (1978, 268). However, Garrido (2002, 15) and Leal (1975, 10) argued that in the Mexican banking sector, there was less competition and therefore banks dominated the accumulation of capital. Of the 50 biggest companies in Mexico in 1970, the major stockholders in eleven were three banks: BANAMEX, Banco de Comercio, and Banco Comercial Mexicano. According to Garrido (2002, 248), these banks accounted for almost 40 percent of the total financial resources in the financial system (see also Del Angel 2010, 650). The presence of the largest private bank BANAMEX was paramount, being the major stockholder of seven of the companies. BANAMEX even had an important presence in the state development bank NAFINSA; the director of BANAMEX was on NAFINSA's board of directors.

Both of the above factors plus others contributed to a persistent balance of trade deficit and to a dependency on foreign capital with all its associated economic problems. The trade deficit averaged 2.7 percent of the GDP from 1951 to 1970. The current account had a deficit of minus 442.9 million dollars in 1965 which grew to minus 1,187.9 million dollars in 1970. In essence, the particular import substitution model employed required foreign capital to finance it, primarily foreign debt.

A further factor that inhibited the formation of capital in Mexico in this period was a regressive fiscal policy. On the one hand, there were various tax exemptions for capitalists and free remittances of profits for foreign capitals. On the other hand, the

<sup>44</sup> This situation was the same for Mexican-owned private companies that operated in these sectors, distributing and commercializing the manufactured products or producing intermediate or nondurable goods, though as noted these sectors were dominated by foreign companies.

government obtained a large and growing part of its revenues by taxing workers, and via foreign debt. Income tax in this period was 19.6 percent of the income revenue, peaking in 1963 at 28 percent (see Figure 3.6). This not being enough to finance the government's spending, the Mexican economy was compelled to borrow abroad. External debt rose from 0.73 percent of the GDP in 1948 to 12.0 percent in 1970.

### 3.8. NAFINSA in the Times of Crisis (1971 - 1982)

This period was troublesome and full of turbulence for the world economy and Mexico. At the international level, it encompassed a world crisis at the beginning of the 1970s and the Latin American debt crisis at the beginnings of the 1980s. The former involved a slowdown in world production and growth. Two other aspects were 1) less demand for exports and 2) an excess of liquidity (Hamilton 1983, 1).<sup>45</sup>

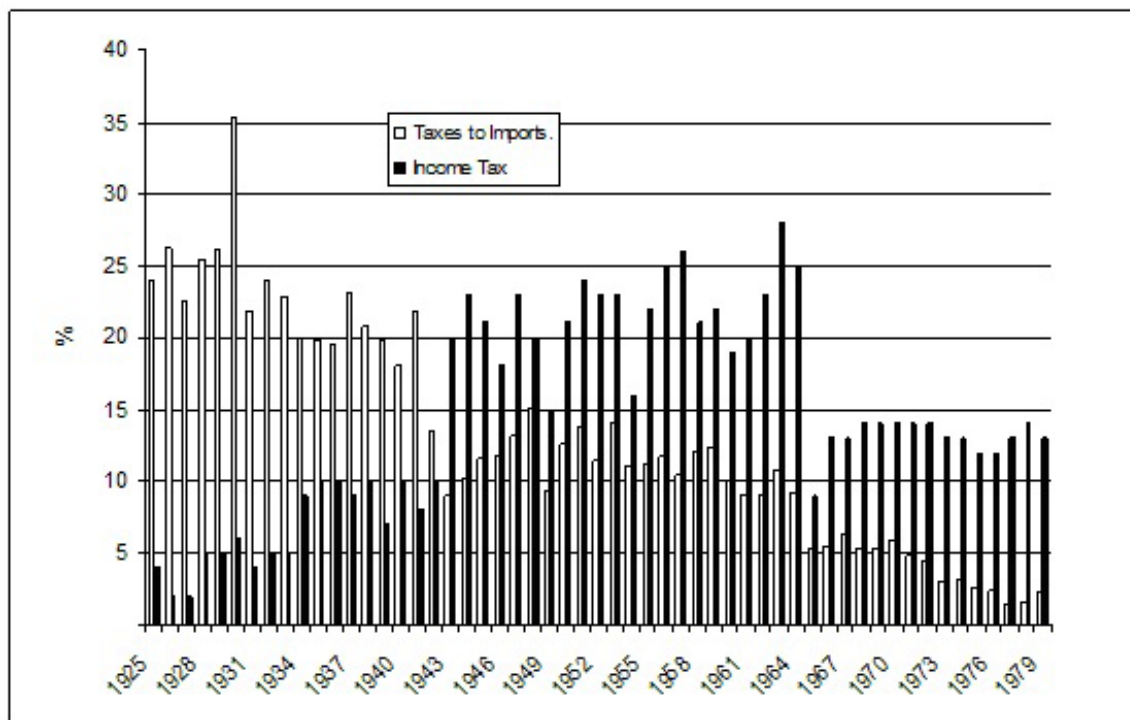


Figure 3.6 Taxes on Imports and Income Taxes

At the beginning of the 1970s, two central objectives of the Mexican government were 1) the improvement of the income distribution, since income per capita had doubled during the period of the stable development but wages were controlled and so income distribution worsened, and 2) the improvement of national companies in order to reduce the high foreign dependency in Mexico's structure of production. Both of these implied increased public spending.

Some people add to these issues political considerations such as the outbreak of social movements in rural areas of Mexico, the impact of the riots of 1968, and the discontent of the middle classes (Ares 2007, 218 and 219), that finally along with the world economic crisis caused the Mexican government to increase its social spending in order to gain legitimacy. I argue that since government spending had not increased by 1971 well after these additional factors had set in and then increased over the following years as the world and Mexican economic crises deepened, it is better to consider the crises as the main factor of the increase of the public spending.

Fiscal deficits in Mexico that had appeared at the end of the 1960s and at the beginning of the 1970s were covered by external debt. As just noted, at this time, developed countries and their commercial banks came to have available a very large mass of liquid capital that they did not want to invest in their own countries (Green 1988, 156). There was a massive accumulation of resources in the world financial system as Eurodollars, and underdeveloped countries and Mexico in particular were candidate locations for these surpluses. The discovery in Mexico beginning in 1972 of vast new deposits of oil both created the need for massive additional debt to finance the infrastructure to access the oil, and provided security for lenders to make the loans. Mexico's external debt increased twelve-fold from 1970 to 1982. While Mexico had economic growth rates

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<sup>45</sup> While it can be argued that the excess liquidity was the result of a long period which generated higher growth of profits than new opportunities to reinvest them at comparable profit rates, the jumps in world oil prices (to make up for long periods of losing value to inflation) in 1973-4 and 1979-80, whose gains went to countries that could not begin to profitably invest them domestically, was certainly a major contribution to the sudden appearance of this massive excess liquidity at this time.

higher than international interest rates, debt was not a problem.

However, when the United States sharply increased their interest rate in 1979, Mexico (and other Latin American countries) could not pay the debt service (interest and amortization), and this gave rise to the debt crisis indicated above.

The dependency from borrowing could have been diminished by a fiscal reform, but this failed in 1973. According to some scholars, this was due to the opposition of the rich to a progressive tax reform, and to the lack of willingness of the president Luis Echeverría to strongly promote it (Hernández 2010, 586; Guillén 2000, 42).

The debt crisis, together with the various problems that had developed in the import substitution model by the end of the 1960s that were discussed at the end of the last section, provoked a structural change in the Mexican economy. This was characterized by a reduced rate of economic growth (see Figure 3.1) and a change (beginning at the end of this period but characterizing the next period) to an export-oriented economy.

The average rate of economic growth over the whole period was 6.0 percent, but this involved great variability. There was an extended downturn from 1974-1977, which ended with a further sharp drop in 1977. This was followed immediately by a strong upturn in 1978 that resulted from the oil boom.

Private bankers opened this period by progressively restricting credit. Even though beginning in 1974 banks were allowed to form multibanks, commercial financing plummeted from 20.3 percent of GDP in 1970 to 13.1 in 1977. Although the oil boom restored commercial lending to 18 percent by 1980, the private credit restriction (both before 1977, and after 1977 in relation to what the oil boom economy needed) led to two problems beyond the limited finance for productive investment itself, a drain of reserves and a dollarization of the Mexican savings system. From 1973 to 1982, there was a drain of at least 23 billion dollars in foreign exchange reserves.<sup>46</sup> In addition, the reserves that existed were coming largely from the public sector (oil and debt) and

<sup>46</sup> Some scholars claim that this drain in foreign exchange reserves could have reached 60 billion dollars (Cárdenas 2010, 528).

not the private sector that the public sector was so focused on promoting (Arriola and Galindo 1984, 130). The dollarization of the savings system was so serious that in 1982, bank obligations in dollars were 50 percent of the total obligations (Garrido 1987, 531).

From 1970 to 1982, NAFINSA and Mexico's other specialized development banks underwent the same turbulence as the country. As indicated above, private financing dropped from 20 percent of GDP in 1970 to 13 percent in 1977, and while it recovered to 18 percent after that, the total capital needs were larger because of the oil boom. The development banks had to cover that gap. They had to provide the financing for the increased participation by the Mexican state in the GFKF from 33 percent in 1970 to 43 percent in 1980. Consequently, public spending rose from 21.9 percent of GDP to 43.6 percent in 1982 (Guillén 2000, 44). Neoliberal opponents of government promoted development argue that the development banks were financing too much investment throughout the 1970s. The data, however, could just as well be read to argue that the private sector was inadequately financing industrial activities and as a result, the state development banks had to fill the gap.

The national turbulence of 1970-1982 affected NAFINSA. This instability can be divided in two periods, from 1970 to 1973 and from 1977 to 1982. In 1971, NAFINSA only had one branch in Mexico, and the approvals for more branches occurred very slowly (Martínez, 1985). In addition, it was not allowed to take domestic deposits (which would have been very limited anyway with its negligible number of branches). In addition, it was not supposed to compete with domestic commercial banks for borrowed resources. As a consequence, during the first period, NAFINSA obtained almost all its resources in dollars from abroad. By the early 1970s, such international lending to developing countries mainly via private banks, as opposed to earlier when much of it came at lower interest rates, came from international agencies such as the World Bank or the Inter America Bank of Development. Further, in the name of the

now sacrosanct belief that “promoting competition” was good for development, NAFINSA now sometimes financed more than one project with a similar objective, even when the combined capacity of the projects surpassed the needs of the Mexican economy. For example, it financed Altos Hornos de Mexico and Las Truchas, both of which were involved in the production of steel. The result was that capital inflows were both more expensive than they had been before and were more than they needed to be. NAFINSA’s activity in the second period was quite different. In response to the growing negative impacts on the Mexican economy of the world crisis, in the second period, it started to again promote industrial activities rather than infrastructure in order to increase the level of employment and industrialization (see Table 3.9).

3.9 Economic Background 4: The Mexican Structure  
of Production and Financing During the Period  
of Financial and Commercial Liberalization,  
1982 to the Present

In the face of the overwhelming debt crisis, Mexico had to solve two problems, one external and one domestic. The latter was by far much easier to solve since it involved negotiations among the Mexican ruling classes rather than negotiations with the most powerful commercial banks in the world involved in the former.

The bank nationalization under the presidency of José Luis López Portillo in

Table 3.9 Compositions of NAFINSA’s Total Financing

Sector	1963	1974	1979	1981	1983	1984	1987
Infrastructure	60.3	65.1	55.7	45.6	20.5	21.2	1.6
Industry	35.6	30.6	28.4	32.4	54	52.4	87.6
Basic	18.4	10.3	16.7	23.1	41.4	39.5	6.7
Manufacturing	17.2	20.3	1.7	9.3	12.6	12.9	80.1

1982, in light of what was just indicated, could be considered as an action to restore the Mexican Peso as the legal tender. However one looks at it, it constituted an action against the wishes of the most powerful elites that have always dominated the accumulation of capital in Mexico (Garrido 1987, 531).

Although the action was against the bankers, the business sector as a whole presented a unified rejection. As a result, under the subsequent presidency of Miguel de La Madrid, the following concessions were given to the financial sector: 1) the provision of dollars at a fixed exchange rate to heavily indebted private companies (through a program called FICORCA); 2) the private sector could hold up to 33 percent of the stocks of the nationalized banks by the end of 1983; 3) brokerage houses were given a monopoly on trading government securities; and 4) with the bonds that bankers received for the nationalization, they could buy the stocks of state-owned companies, which later turned out to be an important compensation (Castañeda 2010, 610). However, even though Miguel de la Madrid made such major attempts to cooperate with the capitalist sector, the capitalists were never satisfied (Hernández 1986, 247).

The nationalization of the banks against the wishes of the elite was considered an exceptional necessity by the state and should not be considered to indicate any significant shift in its attitude toward, or practices regarding, Mexico's capitalists. The existing relationship between the two continued throughout this period, although some tensions did arise from the problems of the time (Dussel Peters 2000; Cárdenas 2010). The 1981 rescue by the state of one of the most important business groups in Mexico, Alfa, is an example of the basic continuation of the relation as usual. The government granted a credit of 12 million pesos for the rescue without demanding any voting rights or any other control over the company (Arriola and Galindo 1984, 125).

Internationally, this period was marked by spread and consolidation of neoliberalism around the world. Neoliberalism is an economic and political project of the capitalist



class whose objective is to increase the rate of profit that had decreased in the 1970s (Duménil and Lévy 2002). In Latin America, imposition (with the ready support of the majority of the Latin American elite) of neoliberal policies was prepared by the debt crisis of 1982. Many countries had to accept Structural Adjustment Programs. These programs consisted of a stabilization program (reductions in public spending or exchange rate alignments) and economic restructuring (trade and financial liberalization and the reduction of the presence of the public sector). The goal of these policies was to ensure the flow of debt payments to the commercial banks of the advanced countries. The implementation of these programs was directed by the World Bank and the International Monetary Fund (IMF). Later, the policies imposed in Latin America came to be considered to constitute a model of development, which came to be known as the Washington Consensus.

Thus, in 1983, an agreement concerning the payments on its debt service was signed with the IMF. In the same year, the Plan Inmediato de Reorganización Económica (PIRE) was implemented. This plan had the goals of bringing down inflation and reducing the government spending. In 1985, the import substitution model formally ended with the elimination of 366 import licenses (Rivera 1993, 156). Already in 1983, the government had started several programs to promote exports such as in the Plan Nacional de Desarrollo and the Programa Nacional de Fomento Industrial (PRONAFICE). Later, it launched another program for exports, Programa de Concertación con Empresas Altamente Exportadoras. It was during these years that NAFINSA's central mandate was correspondingly changed to export promotion (Cypher 1987, 91).

Three further neoliberal changes in this period with which Mexican government hoped to reignite economic growth were (Guillén 2000, 59): 1) allowing total foreign ownership in some industrial branches, 2) allowing the spread over the whole country of the maquiladora structure, and 3) decreasing the state's activity in encouraging both

economic growth and the level of employment. There were 1,115 State Owned Enterprises in Mexico in 1982 that employed almost 1 million workers, 10 percent of the total formal nonagricultural employment (Ibid., 63). By 1988, the Mexican government had sold 743 of those enterprises. Although these companies were not the most significant ones in their contribution to GDP and national employment, it nevertheless marked the savage policy of privatization that would be followed in the future, in which NAFINSA participated strongly (discussed further below).

During the period of 1982-1988, the Mexican economy plummeted sharply twice, in 1983 and 1986, and the average annual rate of economic growth was around 0 percent. The lower rates of economic growth in this period (see Figure 3.1) were a result of the main objective of the neoliberal period being the payment of the massive and asphyxiating debt burden as opposed to growth.<sup>47</sup> The debt service, amortization, and interest payments in many years were larger than the new credit Mexico received. Figure 3.7 shows Mexico's Net Transfer on External Debt, which aggregated to a net outflow of capital of 59.8 billions of dollars over this period.

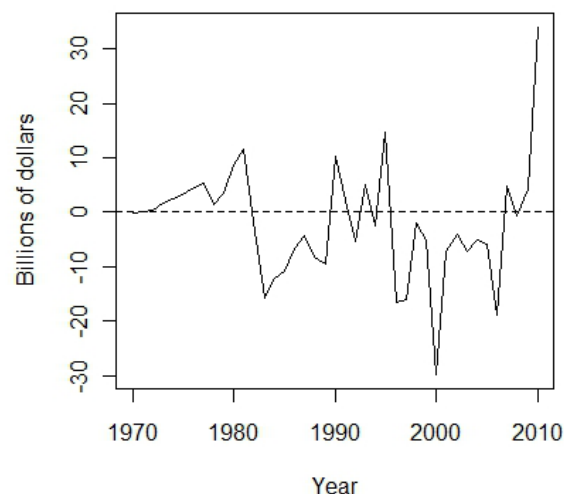


Figure 3.7 Total Net Transfers on External Debt

<sup>47</sup> Neoliberal propaganda asserted that repaying the debt would lead to increased growth (through lower interest rates, etc.), but there was never any empirical evidence that countries that adhered to the Structural Adjustment Programs subsequently experienced above-average growth. There was empirical evidence that they suffered below average growth rates while they adhered to the programs of adjustment.

During the period from 1989 to the present, the rate of economic growth was 2.8 percent, clearly slower than in the period of import substitution. There was an upturn from 1989 to 1992 mainly boosted by the impetus of the commercial and financial liberalization, that subsequently ended with the Mexican crisis of 1994-1995 where it was cut off from foreign capital and suffered a sharp depreciation of the exchange rate. In this period, there was also a large downturn from 2001 to 2003 caused by the US crisis and the slowdown of exports. The main characteristics of Mexico during this period relevant to this study were the following:

1) The role of the state in directing the economy was dramatically reduced in favor of directing the economy by the private sector. This withdrawal of the state was in sharp contrast to all the previous periods considered, which were characterized by a high degree of participation of the state in directing the Mexican economy.

2) Trade liberalization proceeded rapidly. Very soon after the North American Free Trade Agreement (NAFTA) went into force on January 1, 1994, Mexico became one of the countries in the world with the highest percent of its GDP traded: more than 30 percent of the GDP is exports, mainly in autoparts. Mexico's greater import needs, however, have resulted in a negative trade balance from the 1990s onwards. Mexico only had a positive trade balance in 1996 and 1997 and that was due to the crisis of 1994-1995. In this process, export-capitalists benefited the most, while medium and small capitalists that had grown under the import substitution model were severely harmed (Hernández, 1986).<sup>48</sup>

3) The conditions of life of the large majority of people in Mexico have worsened. In 2007, the real minimum wage could buy one and a half fewer products than it could buy in the 1970s. The Mexican standard of living has suffered the most severe deterioration in Latin America under neoliberalism.

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<sup>48</sup> This was the reason why some capitalist's advocates during the import-substitution model such as CANACINTRA opposed the neoliberal era of capitalism.

4) From 1990 to 2009, the GFKF averaged 20 percent of GDP. This is markedly low in comparison with more successful Third World countries in this period such as South Korea, which had 32.3 percent. What the private sector decided to do in relation to forming fixed capital in this period largely determined its rate of formation, since the private sector fixed capital formation constituted on average nearly 80 percent. When it slowed its formation so that its percent of the total formation dropped to 75.2 percent in 1995, total fixed capital formation fell to 15 percent (see Figure 3.8).

5) Total banking credit provided by the private sector as a percent of GDP remained relatively stagnant over the duration of this period. After the 14 month blitzkrieg campaign of bank privatizations in 1991, private credit did start to expand, but that ended with the banking crisis in 1994 and 1995 (in which the government had to rescue the majority of private banks) and total credit returned to where it had been before (see Figure 3.9).

6) The financial liberalization, which had as an objective an increase in the rate of saving and thereby an increase in the domestic resources available for development, instead caused two important aspects of financialization for development to regress. First, the banking system became both more concentrated and more foreign dominated. Foreign banks controlled almost 80 percent of the total assets after the wave of privatizations from 1991 to 1992 (see Garrido and Martinez 2004, 123; Guerrero, Lopez – Calva and Walton 2009, 119 and 120). By 2003, just three foreign banks controlled more than 60 percent of the total assets. This concentration is even worse than in the past. In 1950, there were 240 banks in Mexico, with the top four of them controlling only 40 percent of the total assets (Garrido 2002). Second, the financial liberalization and privatization did not bring any increase in credit to promote production.

7) Mexican private banks continued to practice extensive inside lending very much as they have done for over one 100 years:

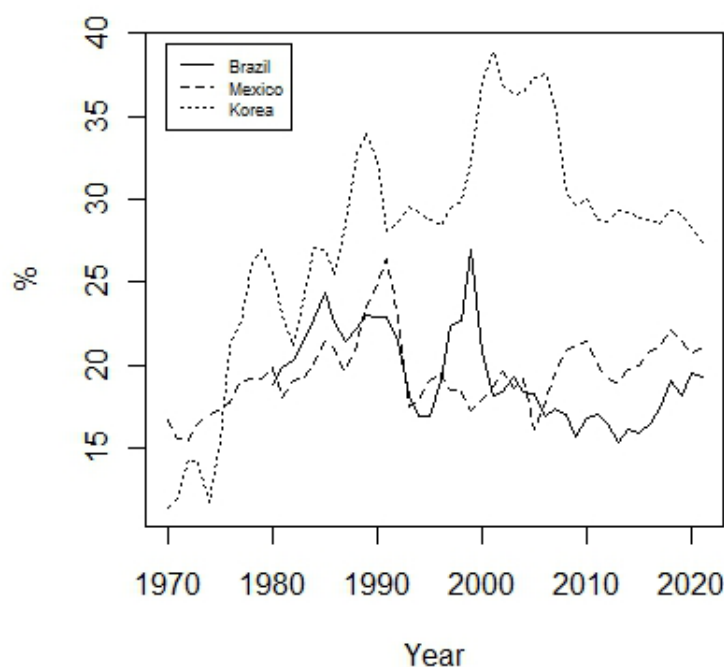


Figure 3.8 Gross Fixed Capital Formation in Mexico. Percent of GDP

Due to the closed nature of the MBGs [Mexican Business Groups], it is an impossible task to be precise with the details of related credit in the Mexican financial system. Nevertheless, by analyzing the financial information of firms quoted on the stock exchange, one can get a first approximation of the phenomenon. With this objective in mind, related credit is defined as the financing received by a firm with a board member who sits on the board of directors of the same bank granting the credit. In the Mexican case, these members, more than being employees of the financial institution, are important stockholders of the MBG that consolidates the lending bank and the borrowing firm... The percentage of board members in a bank with ties to public firms -that oscillates between 13.64% for the Banco Industrial and 100% for Interacciones-. The percentage of board members with related credit -that goes up to 33.3% for Inbursa-. The percentage of related firms that receive credit -that goes from 0% in Quadrum up to 37.9% in Bancomer-. The percentage of related credit with respect to the total credit received by the firms in the sample is larger than 30%, and has even reached 88.12% for Inbursa and 100% for Interacciones, with the exception of four cases (Quadrum, Banamex, Bital and Ixe). (Casteñeda 2000, 13)

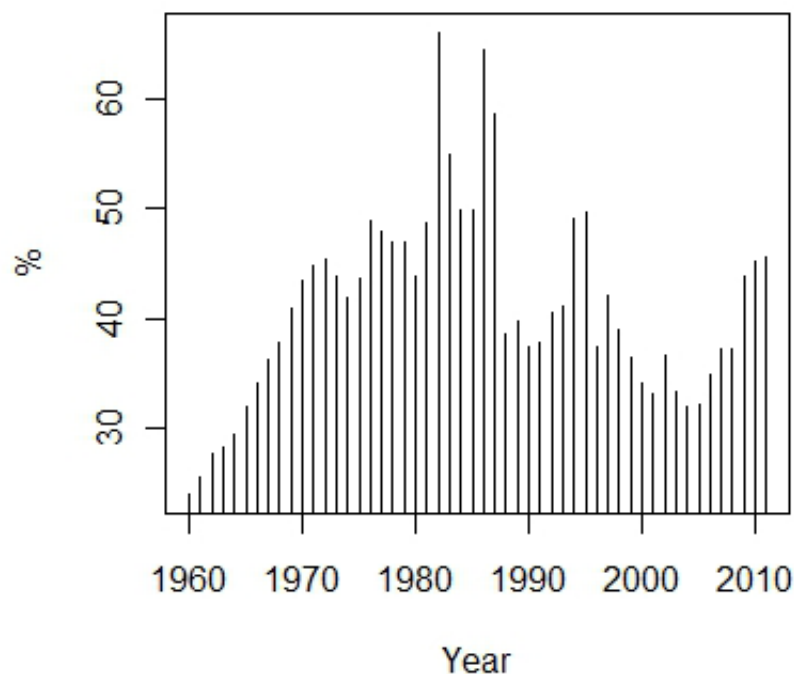


Figure 3.9 Total Banking Credit as a Percent of GDP. Private Sector

### 3.10. NAFINSA in the Period of Transition to Financial and Commercial Liberalization, 1982 to 1988

Over the whole period, NAFINSA's financing averaged 13.9 percent of the GDP, (see Table 3.10), somewhat above but not qualitatively different from what it had been over the preceding two decades (see Figure 3.4). Credit constituted 82.9 percent of NAFINSA's Total Financing, mostly to such activities as chemistry and basic metals (NAFINSA 1986, 1991). The major swings of total financing over GDP in this period (see Figure 3.4) suggest, however, that NAFINSA was not carrying out any well-coordinated long-term industrial policy. What occurred was that NAFINSA was being used as an important source of finance in the neoliberal process of privatizations. One major activity of NAFINSA in this period was just to channel credit to companies which had been selected for privatization strictly for the purpose of preparing them for sale. NAFINSA started this period with 88 enterprises and was down to only with 48 in 1988. It is

Table 3.10 Total Financing in Mexico from 1982 to 1988. Percent of GDP

Year	Total Financing	Commercial Banks	NAFINSA
1982	69.3	22.1	8.1
1983	58.6	20	12.5
1984	52.7	20.2	11
1985	58.8	23.6	13.3
1986	75.9	31.9	20.2
1987	71.5	33	21.4
1988	50.1	22.6	10.9

important to note that the 40 companies that were sold from 1981 (since there is not data for 1982) to 1988 had contributed more than 40 percent of the employment in the companies in which NAFINSA had partial ownership in 1981 (see Table 3.11). During this period, the creation of companies and encouraging the level of employment were not government objectives.

Despite the fact that Mexico had a heavy debt burden in this period, the way in which NAFINSA obtained capital was from foreign loans. Table 3.12 shows the continued high dependence of NAFINSA on foreign borrowing to meet its somewhat higher than before financing requirements that one saw in Figure 3.4. A final change for NAFINSA in this period was that the Mexican government encouraged the development of other financial agents under the ideology of promoting competition to improve efficiency, thus ending NAFINSA's status as the unique legal agent of the government.

### 3.11 NAFIN<sup>49</sup> in the Period of Financial and Commercial

#### Liberalization, 1989 to the Present

The transition that started in 1982 was completed in the period from 1988 to the present. The change was from a capitalism in the period 1941 – 1981 in which the state played a major role in directing the economy to a capitalism directed much more directly

<sup>49</sup> NAFINSA changed its name in 1985 to NAFIN.

Table 3.11 NAFINSA Industrial Participation from 1964 to 1994.

Year	Companies (a)	Workers Employed (a)	Social Capital's participation of NAFINSA (b)
1981	88	175072	40 (c)
1988	48	100162	38.3
1989	59	98652	19
1990	45	69734	10
1991	49	34109	7.9
1992	43	18478	7.8
1993	24	3064	13
1994	32	7107	NA

(a) Industrial companies only, (b) Included services, (c) data at the end of June, 31<sup>th</sup>.

Adapted from Source: Ares 2007

Table 3.12 NAFINSA's Resources %

Source	1983	1984	1985	1986	1987	1988
National	29.1	30.5	25.7	21.9	19.5	30.7
Foreign	70.9	69.5	74.3	78.1	80.5	69.3

Adapted from Source: Ares 2007.

by the market and the private sector. The change was from a capitalism where the accumulation of capital and development were considered the joint responsibility of the state and the capitalist sector (following the Gerschenscron hypothesis) to a capitalism where the market is consider the most efficient allocator of resources, and the state has only to correct small market failures.

The transformation of NAFIN flowed from this ideological position that was fully adopted by the Mexican government by the late 1980s. Private industrial firms, and even projects in the public sector, should receive financial resources via the private sector. This was sometimes argued as being nonideological by claiming that the development banks had become too expensive by the 1970s and that the same finance for private and public projects could be provided at lower cost by the private financial sector.



There was never any solid empirical evidence to support this, and so this claim must be understood just as an attempt to hide the ideological aspect of the change. Development banks were now to be dedicated to a much more narrowly focused aspect of financing (through the private sector), and in particular, they were no longer mandated to promote industrialization.<sup>50</sup>

NAFIN's activities in this period were framed in this context. An important task for NAFIN that remained in 1989 was to finish implementing its Organic Law of 1986. First, NAFIN was to no longer permanently own stock in any company. It was to immediately (as soon as possible) reduce its ownership in all companies to not more than 20 percent,<sup>51</sup> and to not hold stocks in any company for more than 7 years. Second, it had to continue to shift its resources to export oriented companies. And third, it was to shift its support and resources to encouraging SMEs. The neoliberal rationality of this idea was that development banks should direct their credit to sectors that were excluded of capital markets such as SMEs (Werner 1994, 1055), as opposed to being a tool for the government to finance the public sector as much of NAFIN's activity had been in the past.

For all these reasons, NAFIN had to sell many of its stocks. In 1988, NAFIN owned 38.3 percent of the social capital of 48 companies. These companies had a total employment of 100,162 workers, for an average enterprise employment of 2,087. By 1993, NAFIN owned only 13 percent of the social capital in only 24 companies. These employed only 3,064 workers for an average employment of 128, hence much smaller enterprises as required (see Table 3.11).

In addition to its diminished role in financing through stock ownership, NAFIN's role in providing credit changed radically, both in regards to the amount and

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<sup>50</sup> Interestingly, development banks in their new role were more restricted in several ways than commercial banks. For example, they had a 10 percent reserves requirement while commercial banks only had 8 percent.

<sup>51</sup> The law said that in some exceptional cases, it could be 50 percent, though it was not specific what the criteria were to hold that larger amount.

in regard to how it was distributed. By 1989, NAFIN was converted to a second-tier financial institution. It meant that the credit granted by this institution was actually disbursed via private banks and other financial institutions. In line with the neoliberal ideology, NAFIN's role of supporting and promoting the private sector was now transformed into providing government support for the private financial sector to support the private sector, which often (depending on the desires of the private sector) meant to the detriment of Mexican productive activity.

While NAFIN's total financing rose briefly in the late 1990s from its 1989 level, it then began a precipitous fall at the very end of the decade that bottomed out in 2007 at 0.9 percent of the GDP (see Table 3.13). The subsequent recovery since then was very small and partial. The reduction in finance for development was in fact even more severe than this indicates, because NAFIN was directed to switch its financing from the sort of long-term financing that is needed for most development to short-term financing (most is now not over 45 days) needed for the standard operating needs of existing (private) enterprises (Valenzuela 2007, 33).

Table 3.13 Total NAFIN Financing

Year	1990	1992	1997	2000	2003	2006	2007	2008
Total Nafin Financing	6.12	5.75	9.2	3	3.2	1.4	0.9	1.1

## CHAPTER 4

### BNDES' ROLE IN PROMOTING INDUSTRIALIZATION AND DEVELOPMENT IN BRAZIL (1952-2010)

In the previous chapters, this dissertation discussed the functions of a development bank, the birth of development banks in Europe and Latin America, and the role of one particular development bank, NAFINSA, in the industrialization and development of Mexico from 1934 to the present. It was particularly important to divide NAFINSA's performance into two phases, the import-substitution industrialization (ISI) model and the neoliberal period. In the former period, NAFINSA acted sometimes as a banker and sometimes as an entrepreneur having a large influence in the high rates of economic growth achieved by the Mexican economy. In the latter period, the Mexican economy stagnated, and NAFINSA served primarily to facilitate the privatization process and to "correct" what were considered market failures under the then dominant neoliberal ideology.

This chapter describes the performance of a Brazilian development bank, Banco Nacional do Desenvolvimento Econômico e Social (BNDES), from its founding in 1952 to the present. It has a major difference in appearance from the last chapter in that it carries out this task both through a comparison for similarities and differences to the Mexican case,<sup>52</sup> whose nature was presented in the last chapter, and through additional

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<sup>52</sup> The goal of this dissertation is not a complete comparison of the economic development of the two countries, but rather only to consider those similarities and differences that help to understand how development banking operated in both countries. Hence, many other economic similarities and differences will not be considered here.

direct commentary on BNDES itself.

As was the case for Mexico, the investigation of Brazil's development bank requires the following four aspects to be taken into account:

- 1) The evolution of the Brazilian economy.
- 2) The government's policies to promote industrialization and economic growth.
- 3) The nature, structure, and procedures of the financing.
- 4) The role of BNDES, which has been the most important bank in Brazil

concerned with industrial and economic development.

Section 4.1 addresses the first two of these, presenting as much economic background on Brazil as is needed for the case study of its development bank that follows. Section 4.2 considers the founding of BNDES. Sections 4.3 and 4.4 look at the role of BNDES in Brazil's industrialization and economic development during its two ISI periods, 1952 – 1964 and 1965 – 1982, respectively. A division is made between these two periods because from 1964 to 1966, Brazil accepted a stabilization program and attempted to develop financial markets following the US model of banking segmentation. However, by 1967, it returned to using state intervention to promote the private sector. Section 4.5 presents the role of BNDES under neoliberalism, 1983 to 2011.

#### 4.1. Economic Background to the Development of BNDES

A first aspect of their economic histories shared by Brazil in Mexico is their subjugation to a colonial dominance for roughly three centuries (XVI – XVIII). In the last chapter, I briefly sketched Mexico's economic development at the end of that period. Similar details on Brazil likewise made some contributions to its specific subsequent development, but here I will only note the importance of the colonial domination to both of them to making them “underdeveloped” in the early 20<sup>th</sup> century and hence create the conditions that development banks were adopted to overcome.

The following are ten background points on Brazil's economy in the 20<sup>th</sup> century are aspects that are largely similar to Mexico.

1) The qualitatively similar (in regards to other Latin American countries) scale as the two “large” countries in the size of their economy and population.<sup>53</sup>

2) Their rates of growth after WWII and their twofold nature with ISI and the neoliberal periods were similar. First, from the second half of the 1930s until the end of the 1980s, Brazil and Mexico had annual rates of growth around to 6 percent. More specifically in Brazil, from 1943 to 1981, it had an annual rate of growth of 6.8 percent. There were two particularly strong expansions during this time, 1958 to 1962 (the years of the Plano de Metas) and 1968 to 1973 (the years of the Brazilian Miracle). Both expansions were characterized by important planning and state intervention.

In both countries, there was a process of convergence with the US. In 1940, the Brazilian GDP was 5.5 percent of that of the US, while it was up to 14.1 percent in 1980.<sup>54</sup> There was more volatility in the rate of growth of Brazil than Mexico, but this did not affect the magnitude of the rates of growth (see Araújo, Carpena, and Cunha 2007).<sup>55</sup> During this period, two major transformations occurred in both countries; they became industrialized and urbanized. Primary activities in Brazil constituted 29.4 percent of the GDP in 1940, and dropped to 9.8 percent in 1980. Conversely, industrial activities constituted 18.7 percent in 1940, and rose to 34.3 percent in 1980 (see Table 4.1). At the same time, the share of the population that was urban doubled, from 31.3 percent in 1940 to 66.6 percent in 1980. The labor force in manufacturing activities grew somewhat slower, from 10.0 percent of the labor force occupied in manufacturing activities in 1940 to 16.8 percent in 1980. This caused a large increase over this period

<sup>53</sup> Brazil and Mexico together contribute 63 percent of the total GDP of all Latin American countries and comprise 53 percent of the total population (see CEPAL 2011).

<sup>54</sup> These data are from Maddison, (2011).

<sup>55</sup> Araújo et al. (2007, 574 and 575) note that some scholars claim that there is an inverse relationship between instability and growth. These people argue that instability and associated uncertainty were responsible for the Brazilian stagnation in the 1980s and 1990s. These authors present evidence to support their claim that volatility does not have any effect on growth.

Table 4.1 Sectoral distribution of Brazilian GDP. 1900 – 2000. Constant 1949 Prices

Year	Primary	Secondary	Tertiary
1900	44.57	11.59	43.84
1910	39.73	13.08	47.19
1920	38.09	15.72	46.19
1930	35.77	14.81	49.41
1940	29.42	18.74	51.84
1950	22.42	25.64	51.94
1960	16.91	29.85	53.25
1970	14.27	32.52	53.22
1980	9.81	34.29	55.90
1990	10.54	29.97	59.49
2000	11.04	27.74	61.22

of the percent of the population working in informal activities.

Second, after 1980, both countries instituted neoliberal policies, i.e., inflation control, privatizations, fiscal equilibriums, and financial and commercial liberalization. Both countries had a stagnant rate of economic growth over much of this period. According to Baddini (1998), Brazil had to choose this adjustment over growth, and consequently, Brazil's average annual rate of growth dropped to 2 percent and in addition suffered increased and high volatility. The process of convergence with the US stopped after 1980s, and it even marginally dropped to 13.3 percent of the US economy today.

As it can be seen in the Figure 4.1, the annual rate of growth for Brazil and Mexico were similar. Although in the early 20<sup>th</sup> century, Mexico had undergone an armed conflict (which destroyed its financial system and a great part of its economy) and later on suffered more from the Great Crisis of 1929 – 1933 than Brazil, after WWII, the patterns of growth of the two countries were similar. Note in particular that the world important oil shock did cause greatly different results in the two countries as one might expect, since Mexico was an oil exporter and Brazil was a net importer.

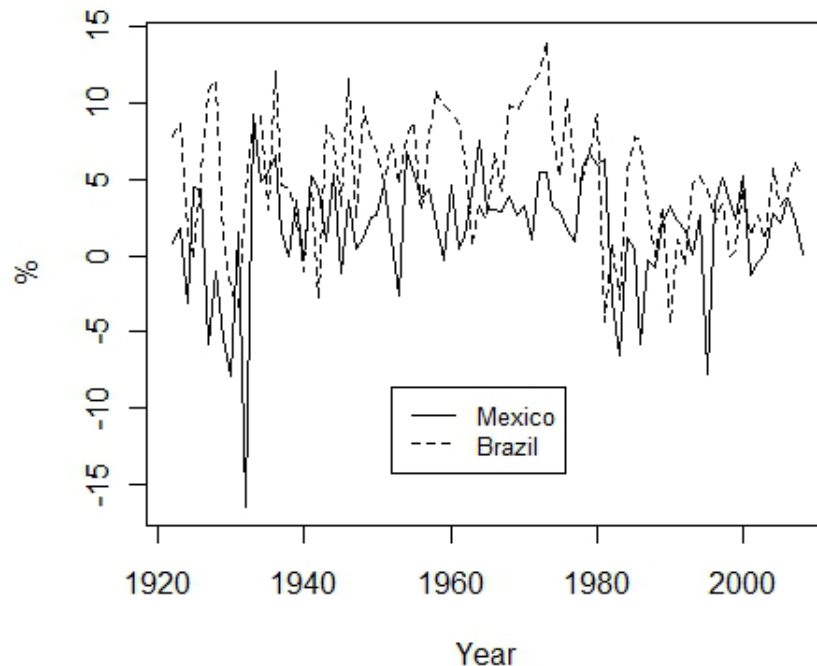


Figure 4.1 Brazil and Mexico. Annual Rate of Economic Growth

3) The industrialization process from 1940 to 1980 with relatively high rates of economic growth was led by the ISI model. However, as happened in Mexico, this model was not as successful as desired and projected for four principle and fundamental causes.

First, building the stock of capital goods (and the capacity to make capital goods) so that they would not need to be imported for continued industrialization was a slow process. Early in the process in the period 1945-1949, the average of capital goods imports over total imports was 39.6 percent, and that had only dropped to 33.4 percent 25 years later during the period 1970 – 1974.

Second, the Brazilian process of industrialization was dominated by foreign enterprises and countries, above all by the US. Almost 40 percent of Brazil's total exports went there from 1945 to 1970. Similarly, during the 1960s, the large inflow of foreign enterprises that located in Brazil to produce what had been imported before led to 40 percent of the manufacturing sector being dominated by foreign companies (Caio Prado,

Jr. 1968). In addition, the most dynamic branches of the economy were dominated by foreign enterprises. These companies benefited from the (trade) protected fast growing domestic markets to make huge profits, of which they then remitted large amounts to their home countries (Baer 1978; Baer 1995; Chudnovsky and López 1998). Connected to these foreign enterprises were Brazilian industrialist whose operations depended on the foreign corporations, and who captured a large share of that part of the profits and benefits from the operation of the foreign enterprises that went to Brazilians (Quartim 1971, 34).

Third, the rate at which Brazil could carry out the import substitution of industrial goods depended on the First World countries in another way. The international division of labor originating in the nineteenth century had assigned to Brazil, and to most Third World countries, the role of suppliers of primary products. Thus, its rate of economic activity and hence the rate at which it could carry out ISI was largely dependent on the level of economic activity of the industrialized centers of the world as the source, through the sale of Brazil's primary goods, of the funds for the ISI.

Finally, it had been hoped that ISI would result in greater economic independence for the country. In fact, industrialization only changed the nature of the dependency relationship. While the commodity composition of imports changed, producing many of the industrial goods that they began to produce required large imports of inputs. The import coefficient did not decline very much, and the result was that the country remained at least dependent on foreign trade and imports as before for its rate of economy activity.

4) Most scholars agree that a many decades surge of industrialization was caused by the Great Crisis and WWII. Like Mexico, however, one important reason that the potential industrialization over this period failed to be realized was a lack of credit. At the beginning of this period, this was largely a result of the dominant practice since the



beginning of the century of granting credit short-term, or only to specific sectors closely linked to agriculture (since the lent capital came largely from agriculture) such as textiles. However, after WWII, the problem became, again like most periods in Mexico, a lack of credit provision by the private sector. The public sector such as Banco do Brasil and BNDES lent for industrialization, but their scale of resources were far short of what could have been successfully and profitably used.

Later, from 1950s until the present, credit was granted by public institutions such as the Banco do Brasil and BNDES:

The financial system of the 1930s was essentially a carry-over from the late nineteenth century. Given the fact that Brazil was mainly a primary exporter, this system concentrated on financing export production . . . Most of the undertaking which required long-term financing were by entrepreneurs with a direct link to the developed financial markets abroad . . . During the period 1947-1966, Brazil lacked developed mechanisms to finance and fund accumulation. Long-term finance was limited to two government banks, whereas private lending institutions confined their operations to short-term loans for working capital. Financial markets were poorly developed and dealt in few securities . . . Medium-term finance was mainly provided the Banco do Brasil, other official banks and, after 1959, finance companies. The main sources of long-term financing were: (1) Banco do Brasil (especially agriculture); (2) the National Bank of Economic Development, after 1952; and (3) the federal saving bank (Caixa Econômica Federal) . . . Given the failure in 1954 – 1973 to develop a long-term oriented capital market, the impatience of the more interventionist sector within the government was growing. The solution found was similar to the one that existed before the reforms: to transfer public funds to finance investment. However, because of the ‘liberal’ orientation of the military government, these funds were directed to the private sector. (Rogério Studart 1995, 100 and 102)

Public banks were by far the largest suppliers of loans in the system, with around two-thirds of the total in the early 1990s. (Stalling and Studart 2006, 226)

5) Like Mexico, the state was capitalist. As there, the government had a very important role in the development of industry from 1950 to 1980. Since that period, Brazil adopted a model of import substitution industrialization in which the state played a central role. Many instruments of industrial policy were employed and the state possessed a high degree of discretionary power to influence many variables and prices in the economy (Guimarães 2010, 49). Rogério Studart argues in the same vein (1995).

Within this frame of a capitalist state promoting industrialization, there were some secondary differences. The last chapter explained that in Mexico, the Revolution brought the petite bourgeoisie to power. It was this class that nationalized the production of maize in the 1920s, the production of oil in 1938,<sup>56</sup> and also developed several institutions to deal with money and promote development. In Brazil, the army, middle classes, and some sectors of the old oligarchy politically triumphed in the revolution of 1930. However, the overwhelming majority of scholars agree that in an economic sense, the old oligarchy remained almost unchallenged until the 1950s and 1960s, as demonstrated by the Brazilian state policy of buying coffee surpluses in order to prevent price declines, to the benefit of the old oligopolistic coffee exporters. To be sure, there was promotion of textiles even under the Old Republic before 1930, and as we will see ISI from 1940 forward. However, the difference was that this process was not so fully commanded and controlled by a new industrial bourgeoisie coming out of the petite bourgeoisie as in Mexico, but as just indicated, still economically dominated by the old oligarchy into the 1960s (Weffort 1968; Prado Caio, Jr. 1960; Quartim 1971; Marini 1965; Castro 2009; Santos 1968). This continued central economic role by the whole old oligarchy was even (of course) reflected in the political sphere, notwithstanding that overall, the Revolution could be characterized as a triumph of the army, middle classes, and some sectors of the old oligarchy as noted above. From the 1930s to the 1960s, there was an agreement between the middle classes and the old oligarchy to keep the pace of changes slow, and in the end, the old oligarchy controlled the parliament almost entirely until 1964 (Furtado 1968). As an example, notwithstanding that in the first Republic with free elections since 1945, recognition of women's right to vote, and party representation in parliament (Ribeiro and Guimarães 1967), the percentage of the population that voted in elections was kept down to only 15 percent (Moreira 2000).

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<sup>56</sup> This is a partial simplification for oil, since it was the oil workers who started the conflict with a strike in 1937 that ended with the nationalization of oil in 1938.

6) Like Mexico even if not as total, Brazil experienced extensive political stability after the 1930s. This was so not only despite the 1930 Revolution, but despite Getúlio Vargas' suicide in 1954 and the military coup in 1964. There was a continuity between the governments of Eurico Dutra (1945 - 1950), Juscelino Kubitschek (1956 - 1961), and João Goulart (1961 - 1964), whose political parties were those that Getúlio Vargas shaped in 1945, the PSD (Partido Social Democrático) and the PTB (Partido Trabalhista Brasileiro) (Castro 2009). Castro (2009) argues further that following the coup in 1964, there was a process of slow and gradual liberalization of the military regime during the 1960s.

7) The partial and at-times cooptation and the partial and at-times suppression or disorganizing the working class.<sup>57</sup> Six processes came together to effect this.

First was the historical culture inherited when this period began. There was weak political participation by the Brazilian people during the old Republic (Santos 1984). Working class organizations were led by Anarchists who did not trust building institutions. There was a step forward during 1917 – 1921 when there were a series of strikes in São Paulo and Rio de Janeiro. This gave rise to the formation of the Communist Party (Partido Comunista) (PC) in 1922.

Second, many in the middle classes were conscious of the need to coopt the working classes at this time. This cooptation was fueled by the way of thinking of the middle classes that made the 1930 Revolution, as reflected in the fact that one of the favorite slogans during the First Republic was “we should make the revolution, before the working class makes it” (Weffort 1968, 62).

Third, flowing from this consciousness of the need to coopt the working class, from the first period of governance of Getúlio Vargas to the coup in 1964, he and the

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<sup>57</sup> Government efforts at cooption ended in this period with the 1964 coup, excepting the few concessions under the dictatorship. A process of reorganization of the class began in the 1970s that was to continue to the end of this period, to the end of the dictatorship, and beyond. The prosecution of the (politically most active) elements of the working class continued through the end of this period.

governments mentioned above as following his general approach successfully coopted significant parts of the working class through their policies.<sup>58</sup>

Fourth, the process of industrialization drew in a large “new working class” that came from the countryside, without any working class history or culture and hence one that was easily coopted by the government (Furtado 1968; Moreira 2000). These workers were partially balanced by the continuation of what had been a small Brazilian working class before the industrialization drive, that now had accumulated some years of class conflict and experience and hence a working class history, consciousness, and culture, and more importantly, by an increase of immigrant workers from Europe with their accumulated experience. However, the size of the inflow from the country contributed stability on net from all these three processes.

Fifth, there was the PC, whose existence in itself was destabilizing for the system but whose political limitations provided stability compared to its potential to destabilize. All left wing forces were grouped in the PC from 1922 to the end of the 1950s when the PC divided. The contribution to stability came from the fact that PC in Brazil had a Reformism program through its entire history (political democracy and the control of the economy by the state) (Silva 2009). However, even that was not taken as sufficiently nonthreatening by the ruling classes and the PC was intensively persecuted at the end of the 1930s,<sup>59</sup> during 1946-1950, at the end of the 1950s, and after the coup in 1964. Although the working class was coopted, it does not mean that there was not class struggle and episodes of extreme violence with people that opposed the regime. Mainly this violence involved attacking the PC.

Finally, the persecution following the 1964 coup succeeded in disorganizing the

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<sup>58</sup> Keep in mind that this was the same period as the even more successful cooption of a large part of the working class by Peron in neighboring Argentina, which of course had political effects on both the workers and ruling classes in Brazil.

<sup>59</sup> In 1935, the PC founded the CUB (Confederação Unitária de Brasil). It grouped 500,000 workers and was a serious challenge to the Getúlio Vargas’ government. Because of that, with the Estado Novo in 1937, the PC was prohibited and its main leaders persecuted (Santos 1984).

left until the end of the 1970s when the Partido dos Trabalhadores (PT) emerged.<sup>60</sup>

8) Like Mexico but markedly more so, the dominance of the middle classes, foreign companies, and the old oligarchy generated an extreme social and economic inequality that was not reduced even by the high and sustained economic growth that was obtained from 1940 to 1980 (Aguilar 1995; Gonzaga and Machado 2003).<sup>61</sup> Based on data from ECLAC for 1963 and 1964, the ratio from the 9<sup>th</sup> and 10<sup>th</sup> deciles to the 2 lowest deciles was 9.4 for Brazil and 16.5 for Mexico<sup>62</sup> (see Table 4.2) (Furtado 1970). Brazil's distribution by the same measure worsened markedly by 1996 to 33.9, though it then improved back down to 21.1 by 2008 (see Table 4.3). The Gini coefficient tells the same story of a worsening distribution over the ISI period and the beginning of the neoliberal one, increasing from 0.5 in 1960 to 0.56 in 1970 to 0.59 in 1980 and to 0.63 in 1991.

9) One explanation for the just documented worsening distribution in Brazil is the deterioration of the real purchasing power of salaries and wages from 1960s onwards (Idem., 480). This again is like Mexico, where both the minimum wage and the yearly manufacturing wage from the 1970s onwards have reduced their purchasing

Table 4.2 Income Distribution in Brazil and Mexico in 1963-1964

	Lowest Decile	2 <sup>nd</sup>	3 <sup>rd</sup>	4 <sup>th</sup>	5 <sup>th</sup>	6 <sup>th</sup>	7 <sup>th</sup>	8 <sup>th</sup>	9 <sup>th</sup>	10 <sup>th</sup>
Brazil	2.8	3.2	4.0	4.4	5.4	6.4	7.7	9.8	14.8	41.5
Mexico	1.5	2.1	3.1	3.8	4.9	6.0	8.1	12.0	17.0	41.

Mexico: Households. Brazil: Individual earners.

Adapted from Source: Furtado 1970.

<sup>60</sup> This party was based on manufacturing (metallurgical) workers but also included old left wing people from the former PC, and left Catholic people that had been organized in different rural Catholic churches. The left wing churches had arisen in the 1950s (Meyer 1999). These churches sympathized with the agrarian reform and made a great contribution in the unionization of peasants. That process ignited first social consciousness and right after that social struggle in the rural sector. According to Meyer, one Catholic organization, La Accion Popular, was the most radical organization at the time of the coup.

<sup>61</sup> According to Aguilar (1995), Brazil and México had a large wave of economic growth which was accompanied by high inequality. In contrast, Argentina experienced lower rates of both economic growth and inequality.

<sup>62</sup> These numbers in Table 4.2 cannot be used precisely for comparisons between the countries because the data are not comparable: Brazil's refer to individual earners and Mexico's to households. Table 4.3 does not have this issue.

Table 4.3 Income Distribution in Brazil and Mexico in 1996 and 2005. Individual Earners

	Lowest Decile	2 <sup>nd</sup>	3 <sup>rd</sup>	4 <sup>th</sup>	5 <sup>th</sup>	6 <sup>th</sup>	7 <sup>th</sup>	8 <sup>th</sup>	9 <sup>th</sup>	10 <sup>th</sup>
Brazil*	0.6	1.4	2.0	3.0	3.8	5.2	6.8	9.6	15.4	52.4
Mexico*	1.4	2.6	3.4	4.2	5.2	6.6	8.2	10.6	15.4	42.4
Brazil**	1	2	2.8	3.6	4.6	5.8	7.4	9.8	15.0	48.2
Mexico**	2	3	3.8	4.8	5.8	6.8	8.9	10.8	14.8	39.8

\* 1996. \*\* 2008

power by 75 percent (Valle and Martínez 2011, 106 - 108). From Figure 4.2, one can see that the level of the real minimum wage peaked at the end of the 1950s and at the beginning of the 1960s, dropped over the 1960s and then stabilized over the 1970s, and then suffered a second major drop with the onset of neoliberalism until bottoming out in 1995 at about one quarter its previous maximum value. From the mid-1990s onwards, there has been some recovery of real minimum wages back to about the level of the 1970s, but still well below their former peak.<sup>63</sup> While unfortunately data on real manufacturing remuneration cannot be obtained, in analyzing Brazil's wages from 1900 to 2000,<sup>64</sup> Frankema (2010, 356) concluded:

Wages in the manufacturing sector showed a rapid increase since 1920. Starting out at levels comparable to the urban minimum wage, the average manufacturing laborer soon became much better off. Especially, during the 1950s manufacturing workers were earning much higher wages than their peers in the rural area and low-productive urban sector. Throughout the postwar era the gap remained large, but all wage workers faced declining shares from the 1960s onwards.

<sup>63</sup> Gonzaga and Manchado (2003, 470) point out two issues that a researcher must be careful with when dealing with minimum wages: 1) the existence of different minimum wages in different areas in Brazil, and 2) the price index to use to generate real minimum wages. In this case, the minimum wage that is provided by the Instituto de Pesquisa Econômica Aplicada (IPEA) has been used.

<sup>64</sup> He presents the official urban minimum wage in the north-eastern part of Brazil 1934-1998, the official urban minimum wage in the south-eastern part of Brazil 1934 -1998, and the average manufacturing sector wage 1920 – 2000.

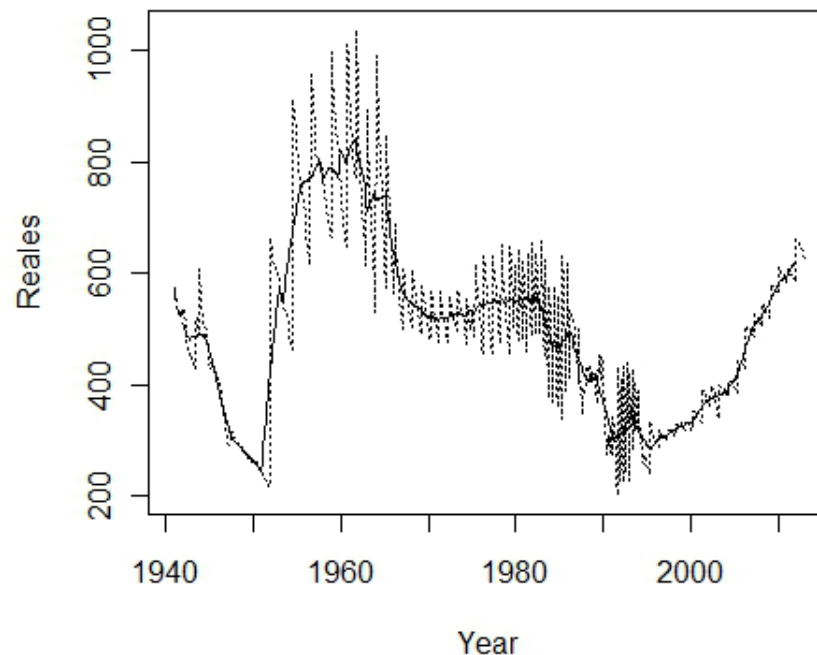


Figure 4.2 Evolution of Real Minimum Wages in Brazil (including benefits). Thick Line 12-month Moving Average. (Constant December 2001 Reales)

10) Like Mexico, Brazil has needed an inflow of foreign capital over most of the period considered (and most of its history), and suffered from the problem of rescheduling foreign debt and defaulting.<sup>65</sup> Just prior to the period of consideration of this dissertation, exports contracted and the debt – export ratio reached 4.0 in 1930, with the debt service absorbing 30 percent of export earnings. As a result, Brazil defaulted in the 1930s, which caused it to have no new access to loans until the 1960s (Abreu 1999).

Brazil and Mexico were two of the largest victims of the aggressive (arguably predatory, unethical and in some cases illegal) policy of lending implemented carried out by the World Bank and especially commercial banks in the 1970s that led to hyper indebtedness and eventually rescheduling and defaults. From 1970 to 1982, Brazil and

<sup>65</sup> However, Brazil and Mexico have not always been capital importers. Mexico was a net exporter of capital during the colonial period (Marichal 2005, 1), and Brazil and Mexico were capital exporters during WWI (Estay 1996, 57). In the period covered by this dissertation, they both became capital exporters during the 1980s against their wills, as lenders refused to extend new loans to them and they continued repayments on old ones. Like a number of Third World countries, Brazil and Mexico moved to have a current account surplus to protect against speculative attacks on their currencies after the many financial crises of that type in the Third World at the end of the 1990s and early 2000s.

Mexico's external debts increased by factors of 16 and 12, respectively. With the rise of US (and from that world) interest rates in 1979, both countries could not pay the debt service in 1982. From 1982 on, Brazil like Mexico but even more so has had a huge debt service burden, as can be seen in Figure 4.3. Average debt service as a percent of total exports has averaged 50 percent in Brazil and 32 percent in Mexico over the last 3 decades.

In addition to all these similarities, there was a particularly important difference between Brazil and Mexico in relation to the issue of the birth of a development bank. This difference came out of the interaction between the nature of the banking system prior to the beginning of the state development bank, and the class structure of the state power at the time of its birth.

1) The history of banking in Brazil prior to the birth of the state development bank was significantly different from that in Mexico that was considered in the last chapter. We saw there that Mexico started its banking with banks focused on promoting development and industrialization (hence “development banks” though not like the

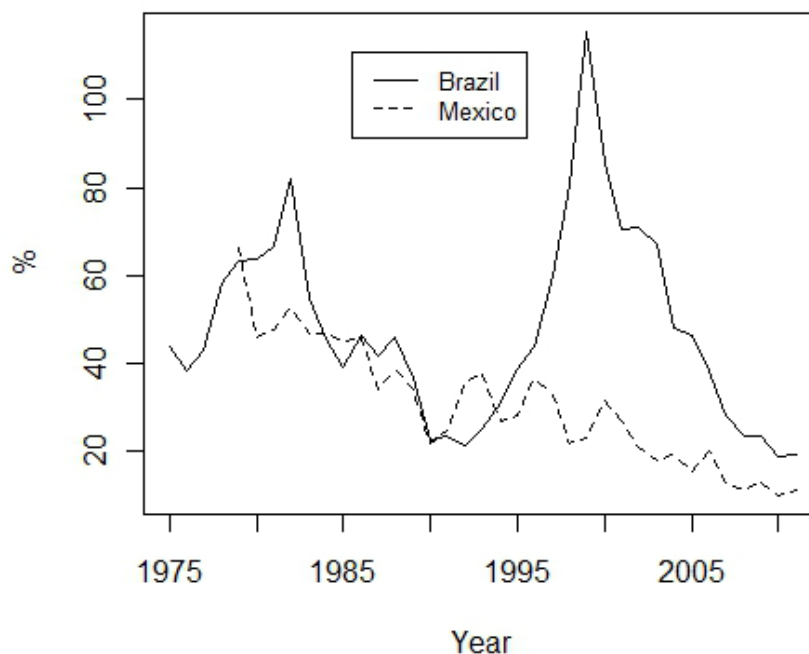


Figure 4.3 Debt Service over Total Exports. Brazil and Mexico



state development banks of the 20<sup>th</sup> century), the Banco del Avío Minero (1784) and the Banco del Avío (1830). On the other hand, Brazil started with a public bank in 1808, the Bank of Brazil (Banco do Brasil). Facing the threaten of revolutionary France, the seat of Portugal's kingdom was transferred from Portugal to Brazil. Once in Brazil, the prince, D. Joao VI, carried out three important economic measures: 1) promoting free trade with countries which were peaceful, especially with England, 2) removing the prohibition of establishing industrial manufacturing in Brazil (Ribeiro and Guimarães 1967), and 3) founding Banco do Brasil in 1808. This bank was created through selling public offerings to the most important Portuguese capitalists (Holanda 1965). It was a mixed bank that could carry out activities such as taking deposits, discounting bills of exchange, or issuing money. However, the important aspect of it in regards to the concerns of this thesis is that its main function was to exchange gold for paper money with the objective of financing the Kingdom's expenses; the promotion of trade and industrialization was only a secondary objective (Holanda 1965; Ribeiro and Guimarães 1967; Cardoso, 2010; Vieira and Bertelle 2009 ).<sup>66</sup>

This first Banco do Brasil closed in 1829. A second Banco do Brasil, or Banco de Maua, opened in 1851. In 1853, this bank merged with Banco Comercial do Rio de Janeiro to create the third Banco do Brasil. By 1855, a regional banking system existed involving other regions of Brazil such as Bahía, Pernambuco, Maranhão, Pará, São Paulo, and Ouro Preto. This banking system contributed to an increase in the quantity of money in circulation, which in particular facilitated the buying of slaves in the face of their increased price that resulted from the prohibition of slavery from Africa in 1850. The essential point relevant to this dissertation is that in spite of the existence of this (not overly extensive) banking system, there was almost no promotion of industrial activities (Haber 1991, 569).

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<sup>66</sup> According to Holanda (1965) and Cardoso (2010), the purpose of finance development in Brazil with the Banco do Brasil was secondary and was never important. On the another hand for Jennifer Hermann (2010a, 6), the bank carried out the function of a development bank but she did not provide any further information.

Following the banking reform in 1905 up to 1930, there was an increased amount of banking and bank activity in Brazil. These banks were led by the Banco do Brasil. By international standards, it was an extremely modest banking system, but it was still larger than Mexico's (Ibid., 570). However, the important difference from Mexico continued to be what these banks did. These banks could, and some of them did, direct credits to the textile industry, but central to their lack of development activity was that neither the domestic banks, the foreign banks, nor the public banks provided long-term credit:

Foreign banks were especially active in conducting foreign currency exchange transactions and they often maintained higher levels of cash reserves than did the reserves of the Brazilian institutions. However, their credit and deposit activities were very similar in nature to domestic banks. All banks focused their business on short-term transactions to support commerce, which was largely concentrated in financing export agricultural commerce.

The Banco do Brasil credit policy was more conservative than that of other banks. By 1928, although the bank still had the largest credit portfolio in the Brazilian banking system, its reserve ratio exceeded the average of other banks by 15 percentage points. (Triner 1996, 56 and 63)

2) The colonial heritage led to a nearly exclusive export-oriented agricultural economy after Brazil's independence in 1822 until well into the 20<sup>th</sup> century. The main Brazilian products to export to the world markets<sup>67</sup> were rubber and, above all, coffee.<sup>68</sup> A fundamental difference between Brazil and Mexico is that in Brazil, there was not the sharp conflict between the petite bourgeoisie and the foreign capitalists and domestic (agricultural based) oligarchs as in Mexico after the triumph of its Revolution. In Brazil, the state did eventually come to promote industrial policies, as we will see in this chapter, but the interest of the old oligarchy was also protected, in particular with the coffee support programs.

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<sup>67</sup> From the 16<sup>th</sup> century until its independence, Brazil boomed due to a "succession of cycles of major export commodities" (Baer 1965, 4). Brazil-wood and sugar were the main export commodities in the 16<sup>th</sup> and 17<sup>th</sup> centuries, with their areas of production located in the northeast part of Brazil. Gold was discovered in the central part of Brazil, Minas Gerais, and became the main export commodity in the 18<sup>th</sup> century, while in the 19<sup>th</sup> century, coffee from the southeast of Brazil was the main commodity.

<sup>68</sup> Coffee's production was based on slave labor for almost the entire 19<sup>th</sup> century. After slavery's prohibition in 1888, the production of coffee was based on immigrant workers.

However, there was nothing like the dichotomy noted in the Mexican case. The Vargas government, in spite of the defeat of the counter-revolution backed by traditionalist groups in 1932, pursued a policy of compromised with the coffee growers, buying up surplus coffee stocks even when these mostly had to be destroyed. None the less, the acuteness of the crisis in Brazil made it extremely difficult to foster any illusion that the export sector could be restored to its former role. Thus, during the 1930s, the Brazilian government tried to unify the home market by eliminating the surviving trade barriers between states; it created the National Steel Company . . . and it promoted the training of industrial workers on a nationwide scale. (Furtado 1970, 91)

In short, the power of the old oligarchy remained strong enough in Brazil to retard but definitely not to arrest industrial promotion.

3) The above two factors, the existence of a broader banking system but one that was oriented to the interests of agricultural exporters and not national industrialization, and the greater political influence of the agricultural oligarchs (and foreign capitalist interests) in the government, led to the influence of the Nation State on the industrialization process, the links between national institutions such as development banks and industrial activities, being weaker and slower to unfold (Furtado 1968). This is why the Brazilian development bank that we will study was founded so much after the Mexican one, but beyond that, this is why there was minimal state promoted industrial development in Brazil in the first half of the 20<sup>th</sup> century compared to Mexico.

Three additional smaller results followed from the lesser use of the state to promote economic development. First, the consolidation of government institutions to deal with the national money was slower and more recent than in Mexico. In 1932, Brazil established the Caixa de Mobilização Bancária (CAMOB) which dealt with real estate, and in 1945, the Superintendência da Moeda e do Crédito (SUMOC). The details concerning SUMOC are not relevant to this dissertation, the relevant point here being only that SUMOC was created instead of a real Central Bank and had some but not all the powers of a real Central Bank, and in particular, it did not have control over the level

of monetary emission, which stayed with the Treasury.<sup>69</sup> Second, given that State – Capitalists ties (either industrial or financial) that we saw were so strong in Mexico, including via its development banks such as in particular NAFINSA, were not so evident in Brazil, the problem of ‘insider lending’ was not a major characteristic of Brazilian business groups (Musacchio and Read 2007). Finally, some scholars even claim that this absence of close State – Capitalists ties resulted in near total autonomy of BNDES from political interests during the 1950s (Willis, 1995). Although I claim (and we will see in this chapter) that there of course were important State – Capitalist ties and BNDES was far from autonomous from political interests, it is true that this relationship of the financial and industrial capitalist with the state was different from that in Mexico, which caused particular differences in the economic development policies and the nature and functioning of the development banks.

With the economic background relevant to the development of Brazil’s development bank established, the rest of this chapter will turn to considering BNDES’s history.

#### 4.2 The Founding of BNDES

BNDE (Banco Nacional do Desenvolvimento Econômico) was founded in November 1952. It was structured in accord with the ideas of the Joint Brazil-United States Mission (CMBEU) which had worked on this project from 1950 to 1952 (Baer and Villela 1980, 423).<sup>70</sup> It actually started operations, however, only in September, 1953 (Idem., 1980; BNDES 2002).

The Bank’s initial objective was to finance infrastructure and basic industry

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<sup>69</sup> SUMOC was set up in 1945 by Instruction 7,293, and specifically had as an objective to “prepare and organize for a Central Bank.” It had the power to fix interest rates, fix a discount rate, manage the exchange rate policy (including setting multiple exchange rates for different imported goods), take deposits from banks, and set reserve requirements on what commercial banks must hold – but they held that money in the Banco do Brasil and not in SUMOC. However, most important for our concern here, and why it was not a Central Bank, it could only request from the Treasury the levels of monetary emission. That is, when it was set up, the government was not willing to give up its ability to determine the level of monetary emissions, and it gave to SUMOC in that regard basically the role of a technical advisor as to what was supposedly the optimal level of money, but not the power to enforce its suggestions on this.

such as steel (Além 1998 and Batista 2002) in order to promote economic development in Brazil. In this sense, the initial role of BNDE was much smaller than that of NAFINSA in at least three aspects: 1) BNDE could not found or have ownership in enterprises, 2) BNDE could not promote the stock market, and 3) BNDE's resources were minimal compared to the resources of NAFINSA.

BNDE's initial resources were projected to come from the US and the World Bank (500 millions of dollars) and internal resources. The Brazilian government submitted an initial request for 387.3 million dollars to realize 41 projects which were described in the CMBEU. However, the US Ex-Im Bank suddenly changed its position and refused almost all funding, and Brazil had to carry out the initiative almost entirely on its own. These internal resources were mostly from the Fundo de Reaparelhamento Econômico (FRE), particularly from income tax and undistributed profit taxes on individuals and enterprises, respectively. One can see in Table 4.4 the 100 percent funding with its own resources from the founding in 1953 and 1954.

Table 4.4 BNDE's Resources<sup>71</sup>

	1953	1954	1955	1956	1957	1958	1959
I. Potential Resources	100	100	100	100	100	100	100
1. Own Resources	100	100	68	43	39	39	38
2. Special Resources	-	-	-	12	13	9	9
3. Other Resources	-	-	32	45	48	53	53
II. Resources Granted	46	22	31	27	66	67	82

Adapted from Source: BNDES 1996

<sup>70</sup> In the 1930s and 1940s, Brazil was searching for foreign resources for industrialization. This gave rise to three Joint Missions between Brazil and the United States. The first one was the Aranha Mission in 1939, the second one was the Cooke Mission during WWII, and the last one before BNDE's foundation was the Abbink Mission in 1945.

<sup>71</sup> "Own Resources" are mostly Fundo de Reaparelhamento Econômico and resources from income taxes. "Special Resources" I and II are from the Wheat Agreements with the US in 1955 and 1956 (Primeiro e Segundo Acordos do Trigo). In these agreements, dollars that the US received from Brazil's purchases of wheat were later transformed into credit lines from the US to Brazil. "Other Resources" are special funds that were managed by BNDE such as the national fund for electrification and the fund of railroad repairs.

### 4.3 BNDE from 1952 to 1963

From 1952 to 1963, Brazil's annual rate of growth was 6.8 percent. The annual rate of fixed investment was 9.2 percent, consisting of an annual rate of growth of 9.4 percent in the private sector and 12.3 percent in the public sector (Figure 4.4). The public investment through the Plano de Metas was important to overall investment and growth during its years (1958-1962) despite its modest overall level (discussed below), and the government also promoted development through special funds (as the Fundo de Reaparelhamento Econômico) and monetary emission. Overall, the years from 1947 to 1963 can be characterized as ones where industrial development in Brazil proceeded with minimal contributions from the private financial system (Studart 1995, 80), with private banks granting almost only short-term credit. The key to development financing of domestic industrial companies was autofinancing and foreign resources, with a secondary role for public credit, and BNDE played only a minor role even in the latter, with the majority of public credit extended by the Banco do Brasil (Studart 1995; BNDES 2002). Foreign capital made significant investments particularly in durables goods where they dominated the most important industrial branches and picked up the technologies that have to be used (Tavares 1977).

The claims in the literature on what BNDE's goals and purpose were during this period vary. Caio Jr says that BNDE's purpose was to promote the private sector (1968, 33). Quartim (1971) also lists this as a central goal and in addition lists making Brazil attractive to the foreign sector. However, BNDE (2002) itself considers its role then to have been to serve as a government tool to promote industrialization in order to keep pace with the world economic expansion and Guth (2006) points out that BNDE's resources were granted to the public sector only. The line of thought on this by BNDE and Guth is also argued by Diniz<sup>72</sup>(2004).<sup>73</sup>

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<sup>72</sup> Diniz (2004, 10 and 11) also argues that the active promotion of the founding of BNDE by Finance Minister Horácio Lafer, who represented the interests of São Paulo industrial capital, indicated that its founding served the interests of Brazilian private capital.

<sup>73</sup> An explanation to this controversy is that BNDES granted credit to infrastructure in areas such as railroads, steel, and electricity which were not rivals but rather complements to the private businesses.

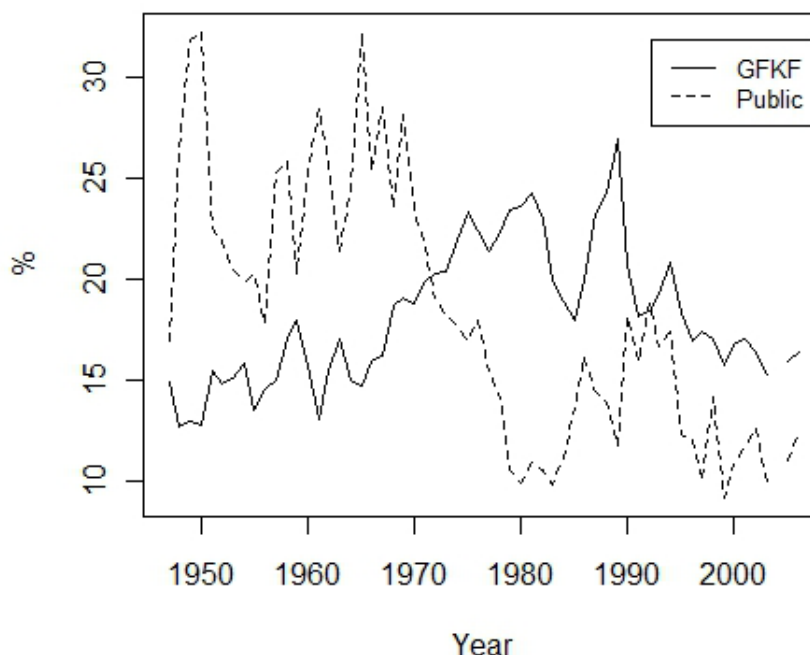


Figure 4.4 GFKF as a Percent of GDP and Public Investment as a Percent of Total Investment

Regardless of its specific purpose and goals, BNDE's resources from 1953 to 1955, while they constantly grew, were scarce and only priority projects were carried out. In 1953, BNDE's resources as a percentage of the GFKF and GDP were 0.69 percent and 0.10 percent in 1953, respectively (Table 4.5). These resources were assigned over these first years with highest priority to railroads, electricity, and the chemical industry, with some variation between years as to their levels and even their order (Table 4.6). However, the any hope that at its birth BNDE could be an industrial promoter on the scale of NAFINSA was far from a reality, given that the resources of BNDE were so minimal.

BNDE's disbursements in this period increased significantly as a share of GDP after 1955 (with variation and significant drop in 1961 -see Table 4.5) with the National Development Plan (Plano do Metas<sup>74</sup>). This plan was based on the ideas of the Joint

<sup>74</sup> Plano do Metas consisted of 30 targets concerning basic industries, transport, and education.

Table 4.5 BNDE's Disbursements from 1953 to 1963 (in percent)

Year	Disbursements/GFKF	GFKF/GDP	Disbursements /GDP
1953	0.69	15.06	0.10
1954	0.84	15.76	0.13
1955	1.33	13.49	0.18
1956	2.10	14.46	0.30
1957	2.89	15.04	0.44
1958	2.33	16.98	0.40
1959	2.09	17.99	0.38
1960	2.06	15.72	0.32
1961	1.48	13.11	0.19
1962	3.94	15.51	0.61
1963	2.35	17.04	0.40

Adapted from Source: Guth 2006.

Commission between BNDE and the ECLAC; according to Baddini (1998) it was the first Brazilian Plan which had an industrial policy. This plan consisted centrally of the following aspects (Diniz 2004, 21):

1. Special treatment for foreign capital.
2. Expansion of the public sector .
3. Increase participation in the public sector in capital formation.
4. Enhancement of the private sector via credits provided by the Banco do Brasil

To fulfill these tasks during the government of Juscelino Kubitschek (1956-1961), the following four measures were taken in order to increase BNDE's resources. The government instituted "a progressive additional income tax, and a 4% tax was placed on undistributed profits. In addition, insurance and investment companies were still required to contribute 25% of their funds to BNDE projects" (Baer and Villela 1980, 427) and finally, the Ex-Im Bank and the World Bank agreed to increase the number of their loans to Brazil.

Notwithstanding the important increase in BNDE's level of operation from 1956 to 1964 compared to its initial years just indicated, it could still only address and execute



Table 4.6 BNDE's Activities in the Brazilian Economy from 1952 to 1963

	1952	1953	1957	1958	1962	1963
<b>Basic Industries</b>		15.5	20.3	47.7	70.9	90.9
• Steel		3.4	7.0	33.5	61.4	85.5
• Metallurgy			5.6	2.7		
• Chemistry		12.2	6	8.4	9.5	5.4
• Paper and Cellulose			1.7	2.9		
<b>Industrial Equipment</b>			4.8	5.7	1.3	0.7
• Electric Material			2.4	1.9		.7
• Transport Material			2.4	3.8	1.3	0
<b>Other industries</b>					0.7	1.5
<b>Infrastructure</b>	100	82.4	73.9	45.9	23.2	6.5
• Electrical Energy		25	54.8	45.9	23.2	5.1
• Transports	100	57.4	19.1		0	1.5
• Railroads	100	50	18.1		0	1.5
<b>Other Activities</b>		2	3.4	2.9	2.9	1.1
<b>Total</b>	100	100	100	100	100	100

Adapted from Source: Guth 2006.

priority projects because the levels were still not particularly high, and especially because it was not easy to obtain long-term credit. Until the end of this period, a high proportion of its spending was dedicated to infrastructure (see Table 4.6 and Sochaczewski 2003):

The Plano do Metas also aimed to intensify the process of import substitution of industrial goods. Industrialization was to be through the integrated development of a domestic consumer durables sector, an intermediary industry and an adequate energy transport sector. In particular, the government allocated 92 per cent of the forecasted budget of public investment to investments in transport, basic industry and energy. (Studart 1995, 95)

But again, the overall level was just so low that it kept BNDE a second tier actor. Notwithstanding that projects in electricity, basic industries, and transports were financed by BNDE, the resources of this bank were only 2.45 percent of GFKF and 0.39 of GDP in 1963. BNDE's resources only covered 20 percent of the total investment during the Plano de Metas (Guth 2006).

#### 4.4 BNDE from 1964 to 1981

With the military coup on March 31, 1964, there was an attempt to establish more market-oriented policies and reduce the state's intervention. It is not an objective of this dissertation to analyze the causes of the coup; see Quartim (1971), Cardoso (1968), Furtado (1970), Marini (1965) for an explanation of these causes. What matters are the policies that were attempted after the coup under the Plano de Ação Econômica do Governo (PAEG). These policies were:

5. Control over wages.
6. Control over public spending.
7. Control over money and credit.

The dictatorship was successful over most of its tenure from 1964 to 1985 with the first goal. One can see in Figure 4.5 that it was also successful, though like with the first goal also at the expense of the popular well-being, with the second goal, after a momentary marginal downturn in its first full year in 1965. To the contrary, its intended reform of the financial system, however, was largely a failure.

The reform of 1964 – 1967 at the beginning of the dictatorship had several components. First, savings was to be promoted by tax exemptions for savers. These savings (by the wealthy) were then to become available to industry in accord with the US model of industrialization via the stock market. The typical third world country foreign exchange constraint was to be relaxed by promoting exports through tax reductions for export-oriented companies and opening the Brazilian economy to direct foreign investment and loans. Stability in the domestic financial market was to be improved by adopting the type of legal segmentation of financial institutions then current in the US (Hermann 2002 and 2010).

In the long run, the PAEG did not achieve the results that were desired and expected, but the period soon after its implementation happened to be the ones of

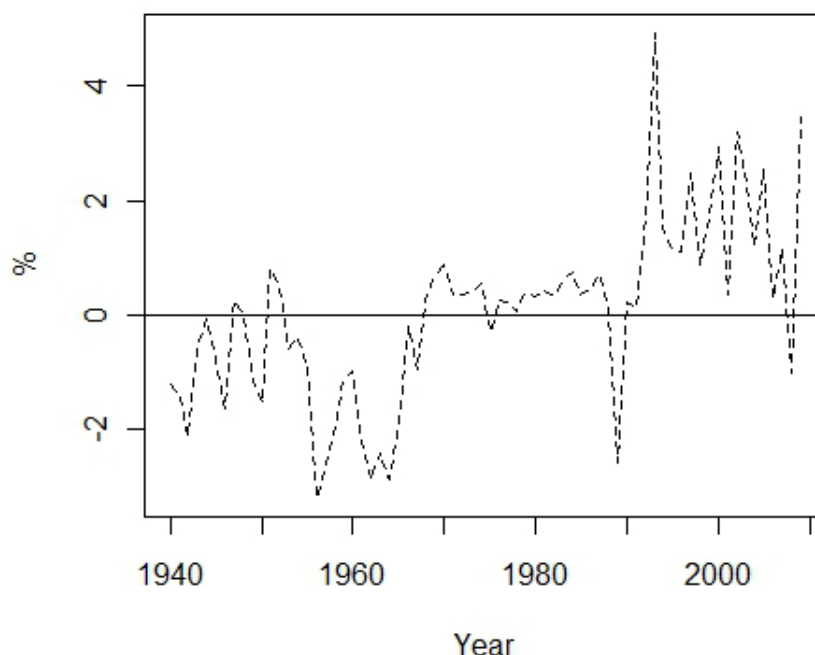


Figure 4.5 Fiscal Deficit or Surplus as Percent of GDP

Brazil's strongest economic growth in its history, the Brazilian miracle from 1967 to 1973. This Brazilian miracle was led by the utilization of idle capacity in the durable goods sector (Studart 1995) and excellent international conditions (Diniz 2004).

The economic boom of the Brazilian miracle was of course reflected in the financial sector, which because of the reforms was able to manifest the following: 1) the number of financial institutions increased, 2) the quantity of bank loans grew as a percentage of GDP, 3) nonbanking institutions grew in number (see Hermman 2002, 78), and 4) the Brazilian housing sector flourished (encouraged by government policies).

The reforms also allowed the following to happen, the harmful effects of which however were to show up fully only after the end of the Brazilian miracle: 1) a higher concentration in banking, 2) investment banks supplied mainly working capital (Studart 1995), and 3) long-term deposits in private banks were not used by the system to promote the process of development. With most industrial investment financing being self-financing, the stock market providing only small amounts of investment capital, and banks'

and investment banks' activities concentrated on short-term and working capital; after the end of the miracle, the capital markets could not be characterized as supplying anything approaching what was needed for healthy economic development (see Hermann 2002; Stallings and Studart 2006).

BNDE's prime role during this period under the dictatorship was to provide financing to the private sector. Already in 1964 and 1965, several programs were created to finance the private sector. The Fund for Technical and Scientific Development (FUNTEC) and the Fund for the Acquisition of Machinery and Equipment (FINAME) were initiated in 1964, and the Financing for Small and Medium Sized Firms (Fipeme) in 1965. At the same time, the Fundo de Reparalhamento Econômico (FRE) discussed above, not having this new focus, was closed in 1964. The effects across industries of the funding and changes in funding at this time was by design unequal. BNDE's disbursements to some basic industries such as steel were reduced (though it continued to support it), while the percent that went to chemistry, equipment, and other industries increased.

During the years of the Brazilian miracle, PAEG continued to emphasize finance for the private sector, in particular basic industries<sup>75</sup> (see Table 4.7). The private sector received 9.7 percent of BNDE's disbursements in 1952-1956 but was up to 75.8 percent by 1973 (Baer and Villela 1980).<sup>76</sup> However, even as BNDE was increasingly focusing its government support on private industry, the government was increasing BNDE's size. BNDE's disbursements rose from 2.1% of GFKF and 0.31% of GDP in 1964 to 6.1% of GFKF and 1.24% of GDP in 1973 (see Table 4.8).

Resources for financing BNDE's projects came from different sources. There was a 20 percent tax on all income receipts (Baer and Villela 1980). In 1967, a financial

<sup>75</sup> During the first years of the 1970s, the mechanisms were set forth according to which private and international capital, and the government, should operate (BNDES, 2002).

<sup>76</sup> Very little of the spectacular growth during Brazil's economic miracle went to the poor, and so in response to the rising social tensions, two new BNDE funds were created in 1974, O Programa de Integração Social (PIS) and O Programa de Formação do Patrimônio Público dos Servidores (PASEP). As indicated, however, by this time, over three quarters of BNDE's disbursements were to the private sector, so these funds were of quite limited size.

Table 4.7 BNDE's Activities in the Brazilian Economy, 1964 to 1973

	1964	1967	1968	1972	1973
Basic Industries	77.5	46.7	29.3	29.9	40.1
Industrial Equipment	1.4	12.1	10.4	4.8	7.7
Other Industries	0.8	9.5	13.7	35.5	25.5
Infrastructure	20.3	25.1	39.3	28.2	17.8
Other Activities		6.6	7.3	1.7	9.0
Total	100	100	100	100	100

Adapted from Source: Guth 2006

transactions tax was introduced. And there continued to be an annual allocation from the federal budget (Diniz 2004).

After 1973, the Brazilian economy started to slow down. According to Studart (1995), the Brazilian economy had reached full capacity. On the other hand, there was a deterioration of the international conditions that Brazil enjoyed as a result of the economic problems that had been growing for years in the US and the 1973 “oil crisis.”<sup>77</sup> In any case, given the Brazil's typical foreign Third World exchange constraint then, the accumulation of capital stopped because trade balance became negative from 1965 to 1980 (see Figure 4.6). The fall in coffee prices made imported goods relatively more expensive. As in the case of Mexico, the import substitution model depended on external finance. An additional aspect that worsened Brazil's economy was the unequal distribution of land and income that crippled the development of the domestic market and increased inflation.

Because of the slowdown of the import substitution model, The Brazilian government initiated a number of policies intended to restimulate economic growth, including among others the II Plano Nacional de Desenvolvimento (IIPND). According to Baddini (1998), this plan and the already mentioned Plano de Metas have been the

<sup>77</sup> There was significant international economic turbulence and disruption, including recessions in the U.S. and much of Europe following the October 1973 “oil crisis” and the subsequent rapid increase (by both the oil procuring countries and the giant international oil companies) in oil prices.

Table 4.8 BNDE's Disbursement from 1964 to 1980 (percent)

Year	Disbursements /GFKF	GFKF/GDP	Disbursements /GDP
1964	2.05	14.99	0.31
1967	3.43	16.2	0.56
1968	2.33	18.68	0.43
1972	5.61	20.33	1.14
1973	6.11	20.37	1.24
1978	12.11	22.27	2.7
1979	10.62	23.36	2.48
1980	9.2	23.56	1.78

Adapted from Source: Guth 2006

only ones in Brazilian history to feature an industrial policy; as a result, at the end of the 1970s, Brazil had the most important industrial complex in Latin America (Guth 2006). This plan was based on government tax exemptions for private businesses and massive resources from abroad. The main focus of this plan was to promote infrastructure such as communications and transport, and manufacturing industries such as automobiles and chemistry.

Another focus of the policies was to deepen government support and encouragement of the private sector. During 1974 – 1979, the industrial sectors that were supported the most through financing and other channels were basic industries (including in particular steel and manufacturing industries) and capital goods. As an example of new approaches to supporting the private sector, BNDE bought several private companies in trouble, restructured them and made them profitable, and then sold stocks in these companies. In total, these operations involved 300 millions of dollars (BNDES 2002). In addition, BNDE expanded its efforts to promote the Brazilian stock market with the creation in 1974 of three subsidiaries which were charged with buying and selling equities. These subsidiaries were Mecânica Brasileira SA (EMBRAMCE), Insumos Básicos SA (FIBA-SE), and Investimento Brasileiro (IBRASA). These subsidiaries were very important since

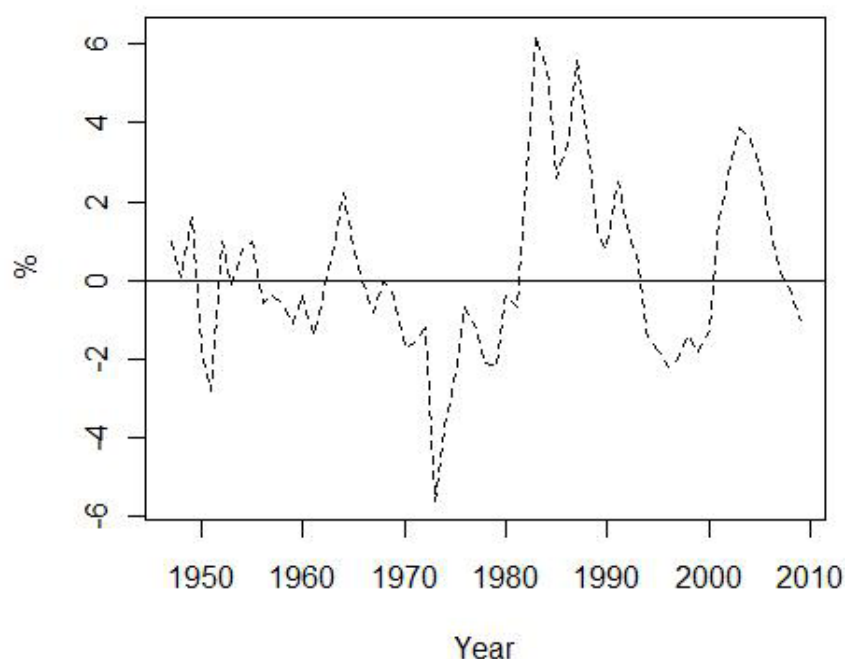


Figure 4.6 Trade Balance. Percent of GDP

they represented 10.7 percent of BNDE's resources in 1979. Then in 1976, the Programa de Estímulo ao Desenvolvimento do Mercado de Capitais was created to contribute still more to the strengthening of the stock market.

Hence, the share of BNDE's disbursements to the private sector continued to rise during the slowdown from 75.8 percent in 1973, to 79.2 percent in 1977, and peaked at 87 percent in 1978 (Baer and Villela; Baddini 1998). At the same time, the government continued to expand BNDE despite the slowdown. Its disbursements rose from 6.1% of GFKF and 1.24% of GDP in 1973 to 12.1% of GFKF and 2.7% of GDP in 1978 before dropping at the end of the period being considered (see Table 4.8) in response to the continued worsening of Brazil's economic performance coming from the continuing decline in its terms of trade, the second oil shock, and then after 1979, the (US initiated) rise of world interest rates.

The three decades that have so far been discussed (1952-1981) were good for

economic growth, achieving an average annual rate of growth of above 6 percent.<sup>78</sup> The role of the government with the provision of credit, short-term via the Banco do Brasil, and long-term via BNDE (especially in the Plano de Metas at the end of the 1970s), was vital to this rate of growth. This last bank contributed especially in areas such as a steel, chemistry, transports, and electricity, using special funds. Hence, BNDE played a very important role in supporting the creation of the most important industrial complex in Latin America.

#### 4.5 BNDES from 1982 to the Present

From 1982 onwards, top priority among Brazil's economic policies, carefully enforced by the US, their banks, and the IMF, was always the payment of its debt service. These had become extremely burdensome following the above noted US initiated jump in world interest rates after October, 1979. Following the 1982 Mexican default, foreign banks sharply reduced their roll-over loans, with which Brazil like Mexico was at great cost meeting its now problematic debt service payments, thus making them still more burdensome.

When debt service repayments have top priority, then unless there is a great abundance of resources, investment in both the public sector and the private sector are restricted. This tends to reduce growth. From 1982 to 2009, GFKF (determined above all by the private sector, given its high percent of the total) averaged only 20 percent of GDP. Growth averaged only 2.6 percent, as opposed to the 6.5 percent growth during the import substitution model.

It should be stressed, since advocates of neoliberalism continue to simply assert without factual support the opposite, that the cause of this problem was not Brazil's former adherence to an import substitution model, since as established above, Brazil

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<sup>78</sup> Despite rather high volatility.



was not consistently carrying out any such model since 1964. We saw above that to the contrary, the military dictatorship had been using the state to promote liberalization and increased openness since it took power. From 1950 to 1967, the ratio of imports to GDP was 6.9 percent, while by 1968 to 1980, that ratio has increased to 9.0 percent. In Mexico, this process was even more accentuated. Martinez and Valle (2011) have argued that contrary to the import substitution paradigm, not only in Mexico where it was particularly acute but throughout Latin America, the elites promoted many aspects of neoliberalism such as openness and privatization well before 1982.

The neoliberal approach to generating the funds to service its debt rested on five pillars: a reduced exchange rate, commercial and financial liberalization, privatizations, and stabilization programs which often included programs promoting the first four pillars and in addition focused on hyper-low inflation and directly on fiscal and trade surpluses, generally involving contractionary economic policies.

Summarizing, from 1952 to the end of the 1980s was a period of sustained and high economic growth which was based on import substitution and industrialization, in which process BNDE played a very important role providing long-term credit above all in the Plano de Metas and in the IIPND. In contrast, the policies of neoliberal era based on the 5 pillars just mentioned<sup>79</sup> in general have generated relative stagnation, and BNDE'S role has changed to promoting and executing the privatization process in the 1990s and to being a second-tier financial institution financing the private sector in the 2000s.

Next, this dissertation will describe the most important features for the Brazilian economy and BNDE in this period.

The most important stabilization programs were the Plano Cruzado in 1986 and the Plano Real in 1994. However, there were others such as the Cruzado Novo (1989-1990),

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<sup>79</sup> This is true even for the period that started in 2002 with Luiz Inacio Lula da Silva. Despite the conditions that brought the O Partido dos Trabalhadores to the presidency and would have served to generate broad support for sweeping social change, Lula da Silva maintained the policies of the neoliberal dogma such as primary fiscal surpluses and government support of the private sector (Morais and Saad-Filho 2005)

Cruzeiro (1990-1992), and the Cruzeiro Real (1992-1994) (Ianoni 2009). The Plano Cruzado consisted of a new unit account and a price freeze, while the Plano Real consisted of a new unit of account, a new coin, and contractionary policies to obtain a fiscal surplus. These contractionary policies included cuts in wages, layoffs in the public sector, and cuts in the education and health budgets.

At the very beginning of this period with the development of the debt burden into a serious economic problem, Brazil responded by lowering its exchange rate to increase exports and reduce imports. As desired,<sup>80</sup> this generated a trade surplus from 1982 to 1995 (see Figure 4.6).

Neoliberal theory promotes commercial liberalization purportedly<sup>81</sup> to improve a country's balance of trade (and from that, its ability to service its international debts). At the beginning of the 1990s, Brazil embraced this approach and reduced import tariffs. Contrary to neoliberal theory, this led to a negative trade balance from 1995 to 2002 as a result of the skyrocketing imports (see Figure 4.6). The debt service continued to be paid, however, with the help of a special fund created ex professo, O Fundo de Emergência Social (FES).

After 2002 until the last couple of years, the trade balance turned positive again (see Figure 4.6) because the international boom in demand for agricultural commodities and their increased prices. Brazil used this surplus to pay down part of its debt and hence lower its required debt service payments. This in turn has allowed it to increase

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<sup>80</sup> As is well known, such an improvement is not a sure thing. This depends on the relation of the elasticity of exports to the elasticity of imports. The Marshall-Lerner condition must be met for such a devaluation to improve the balance of trade.

<sup>81</sup> Neoclassical theory recognizes this is not a logical necessity, that the desired result requires the gains from increased exports and reduced imports to more than offset the reduced income from existing exports or increased cost of existing imports (depending if one calculates in home or foreign currency). Neoclassical policy recommendations then simply assume this will be obtained. Given the absence of evidence that trade liberalization in general improves a country's balance of trade, an alternative explanation presented by many progressives for the strong pressure from the First World on Third World countries to liberalize their trade is that it opens up those countries to gains from the trading (profits) by First World companies, and the asserted neoliberal gains for the Third World country are just ideological covering for the real goal.

its foreign reserves.<sup>82</sup> Total reserves minus gold was 16 percent of total external debt in 2002, while it had increased to 83 percent in 2010.

The purported<sup>83</sup> goal of neoliberal financial liberalization is to increase the quantity of credit granted by the private sector. This thesis argued that this process under this goal was already well under way under the dictatorship in the previous period. The process continued and deepened in this period. In 1987, increased deregulation of, and openness to foreign investors in, the Brazilian capital markets was implemented, and universal banking was legalized. By 1994, the banking system had been extensively reconstructed through privatization and a high rate of interest in order to attract capital (one of the highest in the world). Finally, in the 2000s, foreign ownership of Brazilian banks was allowed. However despite all these extensive structural reforms to promote the Brazilian banking sector, other than two brief spikes at the end of the 1980s and early 1990s, credit to the private sector has remained stagnant (see Figure 4.7). Domestic credit provided to the private banking sector averaged 40.6 percent of GDP from 1994 to 2010. This is almost twice the amount provided in Mexico, but significantly less than the amounts provided in countries such as South Korea and Thailand. In addition, a great part of this credit is directed to the consumer sector.

Stallings and Studart (2006, 230) describe the situation as follows: “the government offers large amounts of well-remunerated bonds . . . These attract the banks to buy securities rather than make loans, thus feeding capital market growth.”

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<sup>82</sup> Following the East Asian financial crisis and others at the end of the 1990s, many of those Third World countries that could began to build up their foreign reserves as protection against the type of speculative attack on their currencies that had cost the Third World so early in the 1990s. It must be stressed that despite achieving significant success in protecting their currencies and hence avoiding such economic losses, it is not without a large cost for these countries. Such reserves represent money earned by the country that could be devoted to development but instead must be held idle, and in fact essentially loaned by these countries to the rich First World countries whose currencies they hold as reserves.

<sup>83</sup> Particularly in the face of the absence of adequate provision of credit by the financial sector in the highly deregulated First World credit markets since the onset of the current “Great Recession,” a number of progressives now argue that the real goal of financial liberalization is to shift the income distribution between the (very) wealthy and the rest of the population, and the neoliberal claims about increased provision of credit are only ideological cover for the real goal.

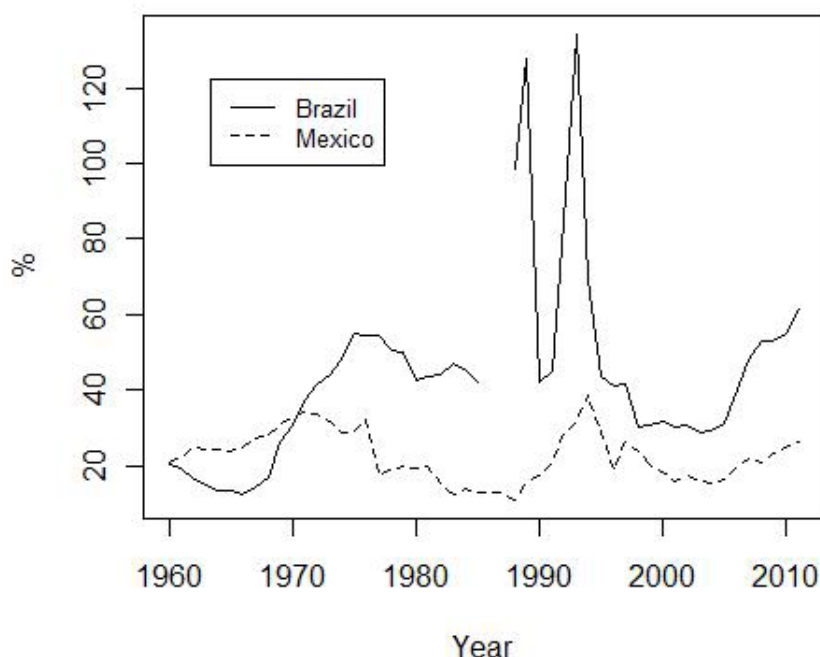


Figure 4.7 Domestic Credit to the Private Sector. Percent of GDP

Finally, privatization of State Owned Enterprises had begun already in the 1970s, but it accelerated in early the 1980s and the 1990s. In 1981, the Special Commission on Privatizations (Comissão Especial de Privatizações, CEP) was established. This commission identified 150 companies, of which 20 were sold for \$190 million from 1981 to 1984. In 1985, stocks for Petrobrás were sold for \$400 million (BNDES 2002). From 1990 to 1995, there was a second wave of privatizations with the Programa Nacional de Desestatização (PND), where privatizations were carried out in steel, chemistry, fertilizers, railroads, and communications. After 1995, there was a third wave of privatizations which allowed 100 percent foreign ownership of companies in Brazil. From 1990 to 2000, 130 state owned-companies were sold for \$100 billion<sup>84</sup> (Guth 2006, 132).

As noted above, with the deterioration of the trade balance there were not adequate resources to finance the public sector. There were cuts in public spending through the 1980s and 1990s. In 1982, BNDE was tasked with managing a new Social Investment

<sup>84</sup> This is the total in Table 4.9 of “Federal Government” and “State Governments.”

Fund (Fundo de Investimento Social, FINSOCIAL). With this, BNDE changed its name to the National Bank of Economic and Social Development (Banco Nacional de Desenvolvimento Econômico e Social, BNDES), and began to finance social programs and projects for food, affordable housing, health, education, justice, and small producers.

However, those social programs never became a priority for BNDES in the 1980s. Other than the years 1983 – 1985 when they constituted from 7 to 17% of BNDES's spending, they were always less than a marginal 5% (see FINSOCIAL in Table 4.9). Rather, BNDES's main priority remained to promote the private sector (Baddini 1998; Diniz 2004). After dropping from 44 to 33 percent in 1983, its private financing grew fairly consistently from then until it constituted nearly all its disbursements by 1990 (see Table 4.10). In 1996, social projects again slightly increased their importance in BNDES with the creation of a special part of it in charge of social development, the *Área de Desenvolvimento Social*.

It is important to note the sharp drop in the percentage of BNDE's resources granted to the private sector from the 87 percent in 1978 noted above to 44 percent in 1981. This cataclysmic drop was caused by the combined effects of the extensive effort to reorganize the Brazilian State Owned Companies in response to the state's spiraling foreign debt, and the simultaneous drive to build infrastructure (Baddini 1998). During these years, many resources granted to the private sector in previous years had to be channeled to the public sector, but as just indicated, the private sector quickly regained its former level.

At the beginning of the 1980s, BNDES financed programs in energy (like alcohol), agriculture (supporting SMEs), and as discussed above, some social projects and carried out projects involved with infrastructure. In the second half of the 1980s, basic metallurgy was the priority area. In the early 1990s, BNDES financed export programs particularly for agribusiness and paper, promoted private infrastructure, and participated

Table 4.9 BNDES Resources According to Subsidiaries and Types of Financing

	1981	1983	1984	1985	1986	1987	1988	1989	1990
Subsidiaries	100	100	100	100	100	100	100	100	100
BNDES	51	72	73	68	62	65	60	55	62
Type of financing	100	100	100	100	100	100	100	100	100
Private	44	35	43	43	53	65	68	81	86
Public	56	65	57	57	47	35	32	19	14
Source of the resources	100	100	100	100	100	100	100	100	100
FINSOCIAL	0	13	17	8	2	2	3	1	0

Adapted from Source: Diniz 2004.

intensively in the process of privatization. In the second half of the 1990s, its most important activities were the continued promotion of exports and the promotion of services such as tourism and shopping centers (Além 1998). From 2000, a major priority of BNDES has been support for very important companies in key sectors, such as in energy with Petrobras and in mining with Vale do Rio Doce. Some of these companies that BNDES financed are today among the biggest in the world. In this same period, BNDES also continued to promote exports, infrastructure, and innovation. The notorious support to agriculture from 2001 to 2005 did diminish after that.

BNDES obtained resources during this period from new funds such as Fundo da Marinha Mercante, Departamento de Construção Naval, and Fundo Nacional de Desenvolvimento. Despite all that, BNDES' disbursements contracted 64 percent in real terms from 1979 to 1990. As a percent of GFKF, its disbursements dropped from 10.6 to 3.3 percent between the same years (Hermann, 2010a) (see Tables 4.8 and 4.10).

As percent of the GFKF, BNDES's disbursements climbed from 8.0% the first year of this period to 11.1% the second, and then continuously fell over the 1980s to a low of 3.1% in 1989. It improved only slightly above that over the early 1990s, but then moved up to 12.5% by 1998 because of its participation in the process of privatization.<sup>85</sup>

<sup>85</sup> As indicated above, BNDES had to buy companies, make them profitable, and then immediately make them private by selling them.

Table 4.10 BNDES' Disbursements (percent)

Year	Disbursements/GFKF	GFKF/ GDP	Disbursements /GDP
1982	8.08	22.99	1.86
1983	11.17	19.93	2.23
1984	9.92	18.90	1.87
1985	8.99	18.01	1.62
1986	7.93	20.01	1.59
1987	7.19	23.17	1.67
1988	5.78	24.32	1.41
1989	3.10	26.86	0.83
1990	3.33	20.66	0.69
1991	4.19	18.11	0.76
1992	4.45	18.42	0.82
1993	3.63	19.28	0.70
1994	4.78	20.75	0.99
1995	5.89	20.54	1.21
1996	7.54	19.26	1.45
1997	12.09	19.86	2.4
1998	12.53	19.69	2.47
1999	10.79	19.10	2.06
2000	11.41	19.44	2.22
2001	11.23	19.47	2.19
2002	15.47	16.4	2.53
2003	12.68	17.78	1.97
2004	12.75	16.1	2.05
2005	13.73	15.9	2.19
2006	13.18	16.4	2.17
2007	13.98	17.4	2.44
2008	15.68	19.1	3
2009	25.93	18.1	4.34

The ongoing process of privatization kept its percent in the formation of GFKF at about that level over the 1990s, only jumping in 2009 in response to the world economic crisis (see Table 4.10).

Even though BNDES played an important anticyclical role at times in this period, its resources now came mostly from private financial intermediaries. That is, similarly to NAFIN, BNDES has increasingly become a second tier bank. For example,

while the percent of BNDES resources granted as a second-tier bank was 41.3 in 2002, it was 61 percent for 2011. In addition, in accord with the neoliberal tenets, almost all its resources were granted to the private sector (see Table 4.11).

This is the end of the chapter where the case of Brazil, with its development bank, was studied. As we have seen the Mexican case in Chapter 3, from now on, we proceed to the conclusions of this dissertation.

Table 4.11 BNDES Disbursements According to the Type of Ownership

Year	Private	Public	Total
2005	96.1	3.9	100
2006	93.4	6.6	100
2007	95.5	4.5	100
2008	97.1	2.9	100
2009	74.9	25.1	100
2010	78	22	100
2011	91.6	8.4	100



## CHAPTER 5

### CONCLUSIONS

The first chapter of this dissertation opened with a motivation for this work, its background purpose. While explicitly indicating this dissertation would not in any way directly address the ongoing discussions concerning the nature of the now-developing Banco del Sur, the background purpose is to draw some lessons about development banking that could possibly contribute to those discussions. This concluding chapter intends to very briefly present three issues related to and arising out of this dissertation. First, it will discuss the methodology used and in particular one aspect of the limitations of that methodology that must be kept in mind in regards to the indicated purpose of this dissertation. Second, it will draw possible conclusions from the material in each chapter and very tersely present them. Finally, returning to the background purpose of this work, without engaging with the concrete existing Banco del Sur at all, it will suggest some lessons concerning development banking that can possibly be drawn from the material in this dissertation which could be included in, and contribute to, the ongoing discussion on the desired nature of the Banco del Sur.

### 5.1 On Methodology and a Particular Limitation to the Relevance of Historically Based Conclusions

This dissertation has used a standard historical-descriptive case study methodology. The goal is to derive conclusions from the study of the history of particular (in this case) institutions, with the background purpose of using that information to contribute to discussions on the desired nature of a related institution currently being formed.

The key possible limitation inherent in this methodology<sup>86</sup> has been explicitly understood ever since Hume pointed out in 1748 that one cannot “logically prove” anything about the future from the past<sup>87</sup> because patterns observed in the past will hold in the future only to the extent that, in regard to the issue being considered, the future resembles the past, which cannot be known a priori.

The core of the situation studied in both the case studies of NAFIN and BNDES is the same as that faced by the Banco del Sur today. The goal remains to accelerate economic and social development through a state-operated development bank, in economies operating in a capitalist mode of production, beyond what private capital would do. Overlaying that core similarity are numerous important differences between the situation they faced over their history and what the Banco del Sur faces today. Three of the most important follow.

First, international capital is much more mobile today. This results from two very different types of causes. First, there are general technical (above all communications), financial, and legal changes in international capital. But equally important is the ideological commitment of the ruling class of most countries to try to reduce all barriers to its capital’s unrestricted movements (one aspect of neoliberalism). The importance of this second and sometimes overlooked aspect of today’s world-wide increased

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<sup>86</sup> Or any other empirical methodology, such as for example the standard repeated controlled experiments of the “hard sciences.”

<sup>87</sup> While simultaneously noting that only a madman would not conduct his life as if one could make conclusions about the future from the past, the only information about the world that we have available.

mobility of capital is highlighted by those few countries that are protecting their economies through existing and/or developing barriers to such minimally restricted international capital mobility.

Second, a broader<sup>88</sup> and stronger domestic wealthy class exists in most Latin American countries than in the time of the greatest successes of NAFIN and BNDES. As opposed to then when the weaker wealthy class often saw the extensive intervention of the State into the economy and in particular into the process of development as a tool to promote its interests, today's wealthy class generally adheres to the dominant neoclassical view among capitalists that a capitalist market economy with minimal direct government intervention is better for their class interest.<sup>89</sup>

Third, 30 years of neoliberalism world-wide has caused a significant and important (far from complete) demobilization of the working class in its defense of its class interests. To be sure, Latin America is the leading partial exception to this, particularly in the new processes in Venezuela, Bolivia, and Ecuador (and in a different way, the longstanding process in Cuba), but more broadly in the masses throughout Latin America. Nevertheless, there too there has been an important weakening of the institutions through which the popular classes could exercise "pressure from below" in favor of progressive liberal policies such as state development banks with a social as well as narrowly economic mission. It is very unclear at this moment in history with the world capitalist system suffering its worst economic situation since the Great Depression at the same time that it is loosing its structure with a single hegemon which has always been best for its

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<sup>88</sup> While the wealthy class is still narrow in comparison with the wealthy class in the advanced capitalist countries, the issue here is that it is broader than it was 60 years ago.

<sup>89</sup> Many liberals (including some capitalists) argue that a "regulated" or "Keynesian" capitalism would in fact be better for capital's interests. Although 30 years of neoliberalism has demonstrated that it shifts the distribution of output in favor of the capitalists, these liberals argue that this is just a bigger share of a less rapidly increasing pie, and in addition that the now largely parasitic nature of neoliberal finance even threatens capitalism's sustainability. The concern here is however not with this debate among advocates of capitalism as to which form is indeed better for its interests, but only to note that the majority of the broader and stronger domestic wealthy class in Latin America accepts the dominant view among capitalists in favor of neoliberalism with its minimal State direct intervention into the economy, and in particular its opposition to state-promoted development.

stability, if in the short-run this demobilization of the working class will be reversed or continue.

The essential core similarity of the issues of the Banco del Sur to the past cases of the Mexican and Brazilian development banks studied argues for the importance of drawing lessons from those cases to contribute to the broad discussion on the desired nature of the former, which has been the background purpose of this thesis. The inherent Humian limitation of such an exercise argues first that one should be cautious with claiming that anything that was successful in the past will necessarily be successful in the future, and beyond that, for trying to consider how the most important relevant changes between the past and the present seem most likely to change the outcomes of past policies and practices if implemented today.

## 5.2. Conclusions of this Thesis Concerning the Historical

### Records of NAFIN and BNDES

The objective of this dissertation was to do a historical review of a development bank in Mexico (NAFIN) and one in Brazil (BNDES) in order to obtain some conclusions which, with the important caution indicated in the first section of this chapter, could serve as contributions to the ongoing discussion about the desired nature of the Banco del Sur, given that the Banco del Sur is intended to operate as a development bank promoting the accumulation of capital in each one of the participants countries. Specifically, this dissertation investigated the structures of these two development banks and the policies they pursued.

With this objective, after the introduction to the dissertation, the first chapter discussed the definition of a development bank. Four aspects were considered: firstly, what a development bank was; secondly, what sectors development banks could foster; thirdly, what type of ownership was possible and desirable; and finally, what kind

of enterprises, public or private, should receive resources. In line with other scholars on this issue, I argued that a development bank can only be defined according to its functions, and that despite large differences on other issues concerning development banks, there is broad agreement among economists that the most salient functions of a development bank are to be a financial intermediary and to promote development.

Already an important conclusion, and one that is among the key issues involved in the discussion on the Banco del Sur, can be drawn from the material presented in Chapter 1 on the definition of a development bank. Within the agreement among most economists just indicated that a development bank should be a financial intermediary and promote development, there are two very broadly defined alternative visions of what that means. The first is broadly neoliberal and rests on “market fundamentalism,” a faith that markets always represent the optimal approach to any economic activity. A strong version of this view argues that development banks should be private, and they should by-and-large focus their attention and effort on the investment needs of private enterprises. This view advocates markets in the provision of finance for development, and markets for execution of development where development is defined as the result of private profit-driven investment. A less extreme version of this same idea accepts the idea of a state development bank, but still argues this bank should lend money to private profit-driven enterprises since they are intrinsically more efficient than any direct government efforts at development. This approach implicitly accepts that there may be a market failure for raising sufficient capital for socially optimal investment and so the state should contribute to that,<sup>90</sup> but continues to advocate private capital and markets for carrying out their concept of development. The alternative “Keynesian” or “developmentalist” vision argues that historical evidence shows that

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<sup>90</sup> Certainly some of the people who accept this view actually adhere to the former view, that it would be better if development banks were private, but accept the existence of state development banks as something historically and institutionally determined that they cannot change (at least in the short term), and therefore take this position to assure that the development funds will in their view be used “efficiently.”

leaving the procurement of development funds to private banks has generally resulted in less funds than are socially desired, and hence, a state run development bank is necessary. Further, leaving the investment of those funds up to private profit-driven enterprises (by having the state development bank simply support finance to private enterprises) does not guarantee optimal development, and in particular the social aspects of development will inevitably be ignored. This issue that already arose in the discussion in this chapter also arose again in this dissertation in Chapters 3 and 4 on the historical records of NAFIN and BNDES.

Chapter 2 considered the birth of development banks (roots in industrial banks) in Europe, Japan, and Latin America, primarily in the 19<sup>th</sup> century. Scholars generally agree that in England, industrialization developed without state financial or technical support, and not even major support of this type through private banks, with the capital rather coming from the profits of merchants and putting-out system and pre-industrialization factory capitalists, and extensive reinvestment of profits from the earliest industrial capitalists. However, other countries then considered it necessary to develop appropriate institutions (we saw that some were private, some were state) “to catch up to England” industrialization. One type of institution that was considered necessary was one that would link savings and banking with industrial capitalists (with the provision of long-term credit to the latter being an early recognized need). Two important early (private) industrial banks in Europe were Société Général pour Favoriser L ‘Industrie in Belgium<sup>91</sup> and Société General du Crédit Mobilier, with the latter operating on a much larger scale than the former, both concerning its channels to mobilize

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<sup>91</sup> Set up at the initiative of the King of the Netherlands (but with private capital) while Belgium was still part of the Netherlands, its industrial banking activities did not move to an important scale until Belgium separated from the Netherlands.

<sup>92</sup> “Part” in the sense that it involved the aspect of a development bank participating in the management of the firm (bringing in technical and other expertise, etc.), but not the part involving financing social development. Note Société Général pour Favoriser L ‘Industrie earlier had provided technical advice to enterprises it supported, but again its activities were very largely restricted to Belgium.

credit, and geographically, dispensing long-term credit not only in its home country of France but in many places in Europe. Then, a further step toward part<sup>92</sup> of the developmentalist concept of a development bank came out of Germany with the development of a deeper connection (no long arm's length via only finance) between banks and productive enterprises. Here, private banks began to not only grant credit to industrial capitalists,<sup>93</sup> but extensive technical advice and, very important, they were also represented on the supervisory boards of joint – stock companies. Japan then represented still another step toward the modern development banks with the major involvement of the state, which mobilized national savings through a state savings system, and then lent that money to banks that then lent it to industry. All these contributed to successful (notwithstanding at great human cost in their early phases) industrialization.

Most works on industrial banks before the 20<sup>th</sup> century focus on Europe and Japan, as just discussed. Much less studied and discussed are a number of early experiments in Latin America. One reason that these get so little attention is that these efforts, despite significant partial and temporary success in the narrow fields in which they were involved, by and large failed to promote the type of broad development that unfolded in Europe and Japan. They were very interesting, however, for a different particular reason. Long before 20<sup>th</sup> century state development banks became common throughout the Third World and a number of states in the First World, these banks were state industrial banks. For example, in the case of Banco del Avío Minero and Banco del Avío in Mexico, obtaining resources and deciding how they would be disbursed was all controlled by the state. They rested on an idea that was not to bloom until the 20<sup>th</sup> century and then was to underpin the majority of development banks in the world (significantly but not entirely diminished by neoliberalism) - if private banks did not have the ability or desire/commitment to promote industrialization and development, the state should coordinate this necessary process.

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<sup>93</sup> Still in the sphere of financial support, they also began to support the efforts of industrial companies to participate in the stock markets.

The basic conclusion I draw from the material presented in Chapter 2 is that institutions to promote industrialization can, at last under the right conditions, promote it successfully. In the 1800s, the European institutions were private and the Japanese structure was a private-state combination, but under the conditions of blooming capitalism (as measured by capital accumulation – often in a humanly very harsh process), the profit motive for private institutors to mobilize credit for private industry proved to be sufficient. This will serve as a point of comparison for the conclusions drawn below from the main investigation of this dissertation in the two following chapters, the development banks in Mexico and Brazil in the 20<sup>th</sup> century.

Chapters 3 and 4 on the Mexican development bank NAFINSA and the Brazilian development bank BNDES constituted the bulk of this dissertation. There were a number of important similarities informing the two cases - the push to originating their import substitution industrialization models coming from WWII, the relatively good growth during the Golden Era of capitalism and some gains in industrialization, the dominant belief among both economists and politicians after WWII that industrialization was key to the development of the Third World,<sup>94</sup> the world-wide acceptance of the appropriateness of development banks after WWII (at least for the Third World), the countries' deepening indebtedness that grew from the 1970s onward<sup>95</sup> and led to the debt crisis and its devastating impact on Latin America, and the embrace of the neoliberal ideology from the 1980s onward<sup>96</sup> resulting in redefining development banking.

However, in addition to these often noted common characteristics, there are two others that I discuss in these chapters that are less noted, but I argue are more important

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<sup>94</sup> With Raul Prebisch and ECLAC, who focused their work on Latin America, being among the most famous proponents of this nearly universally held position.

<sup>95</sup> There is still a disagreement among economists concerning if this was an intrinsic result of any ISI policy, or if (noting that ISI policy did not lead to over-indebtedness for over 2 decades) it was rather the result of the way the ISI policy was carried out starting in the 1970s when not only was credit cheap but First World banks were extremely aggressive, even predatory, in their lending.

<sup>96</sup> Important elements of the neoliberal ideology of development were incorporated piece by piece in both countries even before that, most clearly in Brazil from 1964 onward but also in Mexico from the late 1970s onward – but the jump to a full embrace of neoliberal ideology in the 1980s was still a quantum leap.



to the issues of development banking and development. First and most important, there was the inadequate commitment or even desire by private banking to provide finance (not to talk of technical assistance or participation in management) to develop industry (and of course no interest in providing finance for social development) at any level near what the potential growth of the countries' industrialization would require (arguably different from the cases of Europe and Japan in the 1800s considered in Chapter 2). This situation was fundamental to mandating state development banks to provide finance if industrialization was not going to languish far below its potential. Second, given this state role, the continual variation in what got financed and what the nature of the financing was made it clear that neither country had anything resembling even a medium-term industrial policy, a clear commitment to what development goals they would pursue for the medium-term, and with that what development economists sometimes refer to as "patient finance."

Chapters 3 and 4 bring out differences between the two cases, that were important to the detailed development of each, but do not affect the central conclusions from these chapters that I will discuss after indicating some of these differences. In Mexico the petite bourgeoisie triumphed in the Mexican Revolution, and because of that (even as they mixed with the old bourgeoisie to become the new endogenous capitalist class), there was a higher degree of conflict ("nationalism") in regard to foreign capital there throughout the Golden Age than in Brazil. Although in Brazil just as in Mexico there was a desire for rapid industrialization in the 1950s, the approach of trying to incorporate the agricultural capitalists as opposed to simply pursuing industrialization (even the actions of the development bank reflected this) delayed an accumulation of industrial capital, and further contributed to the slower formation of national institutions to deal with money. While it did make some contributions to Brazilian industrialization, BNDES' participation was significantly less than NAFIN's in Mexico.

The partial and proto neoliberal policies (a drive to “liberalize the economy”) initiated by the military in Brazil after its 1964 coup meant not only that the less neoliberal<sup>97</sup> role of Mexico’s development bank was stronger, with many non-neoliberal aspects surviving up to the debt crisis at the beginning of the 1980s which brought the full embrace of neoliberalism in both countries.

I draw the following fundamental conclusions concerning the practices of these development banks from the material presented in these chapters. The primary one is that the goal of both of these banks was not development per se, but rather the development of capitalism, as manifested both by their policies and their total domination by the private banks and industrial capitalists.<sup>98</sup> It must be underlined in this regard that although they were (correctly) called development banks and indeed undertook social development programs that a truly industrial bank would not have engaged in, these were almost always a minor to almost negligible part of their total spending. They indeed also often committed major funds to public infrastructure necessary for the development of capitalism which again purely industrial banks would not have invested in, but that had to do with the changed manner of such infrastructure development to being necessarily public in these countries, from its private nature in what were to become First World countries in the 1800s – railroads were a major part of the investments of the early European industrial banks, and to a lesser extent other transportation and communications industries. This commitment by NAFIN and BNDES to developing capitalism as their central goal came out among other places in the commitment of each bank to

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<sup>97</sup> As will be discussed at length in the conclusions about this period, to say Mexico was less neoliberal in its policies at various times does not in any way imply they were less procapitalist. The procapitalist nature of the desired development and from that the activities of the development banks were essential to how they performed. The neoliberal versus non-neoliberal way they pursued this goal was important to their specific behaviors but secondary.

<sup>98</sup> At particular periods, particularly a number of periods under neoliberalism, one bank or the other was dominated entirely by the bankers (or more broadly, capitalist finance), to the exclusion of the industrial capitalists, and the goal of industrialization fell almost completely to the side in favor of using these development banks simply to finance whatever capitalist sector “the markets” indicated was most important to support. In practice, under most of the neoliberal period, this was reduced in practice to financially supporting whatever sector was believed to have the greatest potential for generating foreign exchange earnings, originally for debt repayment to First World private banks, and then over the last decade to accumulating foreign reserves to protect their currencies against speculative attacks.

developing the country's stock markets (particularly NAFIN, which included participating with its own securities, that is, like a private capitalist enterprise), and more broadly the country's financial markets (which again were even weaker in Mexico than the weak financial markets in Brazil).

This given commitment to developing capitalism then immediately poses the question – why was this role not carried out by private banks as it had been in Europe (or even in Japan, where the actual investment was by private banks) in the 1800s? The surface answer is indicated in these two chapters, and above in this chapter – the private banks were not interested in financing industrial development, as they had been in Europe and Japan in the 1800s. The simple reason for this was that in the 1800s, financing industrial development was equally lucrative for the private banks with other options for lending. In the 1900s, in Mexico and Brazil and in fact through most of the Third World, while there were some prize industrial projects that promised to be lucrative, in general, private banks had more lucrative alternatives (lending to their governments or financing government projects of any type, including military expenditures, etc.), funding consumption by their rich, speculating in land, and so on). The result was not that there was no private finance funding of industrial development in these countries, but rather that the amount was far short of the amount needed in accord with their potential for industrialization. A second reason for state development banks in these places at this time instead of the private industrial banks was that, notwithstanding the small amount of the total portfolios that it constituted, appearing to be doing some spending on direct social needs had become politically necessary because of the rise of the “pressure from below” from workers and the oppressed, and private industrial banks by their nature could not carry out this role.

### 5.3 Proposals for the Banco del Sur Based on the Conclusions of this Thesis on the Historical Records of NAFINSA and BNDES

It is necessary to divide the possible contributions to the debate on the desired nature of the Banco del Sur that are connected to the conclusions of this dissertation into two groups (which unfortunately are often blurred together in the discussions) – those concerning industrialization (and to some extent related “narrowly economic” concerns), and those concerning development (which involves above all human well-being). While my concern with a development bank is in the first place the latter, the lessons from NAFIN and BNDES (and the other material in this dissertation on earlier industrial banks) more directly addresses the former, for reasons I have mentioned and will repeat below.

Concerning industrialization, this dissertation established that both NAFIN and BNDES were above all committed to supporting the development of capitalism, not to industrialization per se. This was particularly clear once they adopted the neoliberal ideology, which openly accepted that whatever capitalism perceived was best for itself was where social resources should be directed, and largely abandoned industrialization as a central goal for development (generally keeping it as a secondary goal, to be pursued “when markets indicated it was appropriate”). The weakening (far from being “overturned”) appeal of neoliberal ideology today among some supporters of capitalism has returned the goal of industrialization as necessary for, or at least key to development of, all debates on development, including the desired nature of the Banco del Sur. The only certain conclusion from the presented history of NAFIN and BNDES is that they were never consistently committed to industrialization (abandoning that goal completely under neoliberalism, and being inconsistent and erratic during the Golden Age), and it is then arguable that as a result of that, they only had isolated successes industrializing (of-

ten exactly what the development banks did support), as opposed to promoting successful industrialization. Beyond that, by any measure of development, these countries achieved no relative success in development (i.e., in closing the development gap with the First World). The failures of both development banks in these regards suggests trying the other long-proposed alternative – that the Banco del Sur should be consistently (and “patiently”) dedicated to promoting (coordinated) industrialization among its member countries.

While arguably not inherent in all drives to industrialize, we saw that both Mexico and Brazil did develop large debts (some of it from efforts to industrialize, much of it from other causes) in the 1970s that became deadly after the U.S. initiated explosion of world interest rates in the 1980s. This suggests that private international loans are a dangerous source to finance this industrialization. Internal sources would be safer. And one will have greater success at mobilizing large amounts of internal finance if one operates over a larger economic area than the relatively small economies of any single Latin American country (even Brazil or Mexico, and much more so for other Latin American countries). Hence the importance of the Banco del Sur involving as many related countries as possible to be able to minimize their external borrowing for industrialization.<sup>99</sup>

The positive lessons concerning social development from the two case studies are minimal, since as has been noted, neither one ever committed major parts of its resources to this goal. What can be observed is a suggested negative lesson that in both countries, relatively small amounts of resources were directed to social development (by the development banks or any other sources), and that there was no relative social development (catching up with the First World) over the lifetime of these banks.

However, beyond considering social development in its most important aspect as a goal in itself, the increased standards of living that are part (not all) of social deve-

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<sup>99</sup> It would also be important if First World countries would return to significant country-to-country financing at below market rates of interest and for long terms as they used to during the Golden Age, instead of forcing Third World countries to turn to (First World) private banks for needed foreign financing, but that is outside the scope of this section’s proposal for the Banco del Sur, as well as apparently highly unlikely to happen.

lopment enter back into the more “narrowly economic” debates. As has been stressed ever since Adam Smith, industrialization is linked to having markets to sell the industrial products to. For the last half century, conservative theory has argued for “export promotion” to secure such markets. However, in today’s world, where essentially every country in the world that wants to increase its industrialization is looking to be a (net) exporter, simple math (as well as the reality facing many countries that they cannot do that) makes clear this is not possible for all countries. The idea of the need for all countries to develop their internal markets to allow successful growth and industrialization throughout the world (an idea Keynes wrote on at length, and he took to Bretton Woods in his initial proposals) has returned to a central role in development debates (though not yet to the policy orientations of the First World dominated International Financial Institutions like the IMF and WB). A suggested lesson from the observed failure of NAFIN and BNDES to successfully promote significant development is that the Banco del Sur needs to give social development a much greater role in its set of goals than did either of them. And it must do so not only because the goal of economics should be human development itself, but also because along the lines Keynes argued, this is key to developing the internal demand that is necessary for what development economists have long pursued, “endogenous development,” development primarily driven forward by an internal dynamic.<sup>100</sup> And again, this can occur more easily over a larger potential internal market that the Banco del Sur should help to create.

This section of the concluding chapter is concerned with conceptual issues confronting the Banco del Sur that are related to the material in this dissertation. In fact, there are two relatively well-defined positions. The one argues for a development bank that is oriented toward developing capitalism, is neoliberal, and strongly resembles the IMF/WB joint institution (not even committed to industrialization, but rather pursuing

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<sup>100</sup> Conservative opponents continue to disingenuously refer to any such efforts to promote endogenous development as pursuit of autarky, which is clearly an entirely different thing than endogenous development as just defined here.

that when markets say it's best, like BNDES and NAFIN over much of their history). The other argues for a development bank that is focused on human development, which means a joint focus (with significant resources for both) on industrialization and economic development and on social development. I hold the material discussed and analyzed in this thesis, and in particular the relatively modest to outright poor performances of NAFIN and BNDES which tended to be worse during those periods when they more closely fully approached the former model, supports establishing the nature of the Banco del Sur as the latter.

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